FEDERAL RECEIPTS AND COLLECTIONS

17. FEDERAL RECEIPTS

Receipts (budget and off-budget) are taxes and other collections from the public that result from the exercise of the Federal Government's sovereign or governmental powers. The difference between receipts and outlays determines the surplus or deficit.

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the following Chapter.

Growth in receipts. Total receipts in 2006 are estimated to be $2,177.6 billion, an increase of $124.7 billion or 6.1 percent relative to 2005. Receipts are projected to grow at an average annual rate of 6.7 percent between 2006 and 2010, rising to $2,820.9 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation.

As a share of GDP, receipts are projected to increase from 16.8 percent in 2005 to 16.9 percent in 2006. The receipts share of GDP is projected to increase annually thereafter, rising to 17.7 percent in 2010.

Table 17–1. RECEIPTS BY SOURCE—SUMMARY

(in billions of dollars)

	2004 Actual	Estimate					
		2005	2006	2007	2008	2009	2010
Individual income taxes	809.0	893.7	966.9	1,071.2	1,167.2	1,245.1	1,353.3
Corporation income taxes	189.4	226.5	220.3	229.8	243.4	252.4	257.6
Social insurance and retirement receipts	733.4	773.7	818.8	866.2	911.7	959.1	1,016.2
(On-budget)	(198.7)	(212.4)	(225.6)	(237.0)	(247.2)	(258.4)	(273.0)
(Off-budget)	(534.7)	(561.4)	(593.2)	(629.2)	(664.6)	(700.7)	(743.2)
Excise taxes	69.9	74.0	75.6	77.2	79.0	81.0	82.9
Estate and gift taxes	24.8	23.8	26.1	23.5	24.3	26.0	20.1
Customs duties	21.1	24.7	28.3	30.6	31.9	33.9	35.3
Miscellaneous receipts	32.6	36.4	41.6	45.6	49.5	52.6	55.4
Total receipts	**1,880.1**	**2,052.8**	**2,177.6**	**2,344.2**	**2,507.0**	**2,650.0**	**2,820.9**
(On-budget)	(1,345.3)	(1,491.5)	(1,584.4)	(1,715.0)	(1,842.4)	(1,949.3)	(2,077.7)
(Off-budget)	(534.7)	(561.4)	(593.2)	(629.2)	(664.6)	(700.7)	(743.2)
Total receipts as a percentage of GDP	16.3	16.8	16.9	17.2	17.5	17.5	17.7

Table 17–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2006	2007	2008	2009	2010
Social security (OASDI) taxable earnings base increases:					
$90,000 to $93,000 on Jan. 1, 2006	1.4	3.8	4.2	4.8	5.4
$93,000 to $97,200 on Jan. 1, 2007	....	2.0	5.4	6.1	6.9
$97,200 to $101,400 on Jan. 1, 2008	....	....	2.1	5.5	6.3
$101,400 to $106,200 on Jan. 1, 2009	....	....	....	2.4	6.5
$106,200 to $111,300 on Jan. 1, 2010	....	....	....	....	2.6

ENACTED LEGISLATION

Several laws were enacted in 2004 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

WORKING FAMILIES TAX RELIEF ACT OF 2004

The Working Families Tax Relief Act of 2004 (2004 tax relief act), which was signed by President Bush on October 4, 2004, was the fourth major tax measure enacted during this Administration. In addition to extending key parts of the President's tax relief plan for working families, which were scheduled to expire at the end of 2004, this Act provided tax relief to certain military personnel with families, created a uniform definition of a qualifying child for tax purposes, and reinstated a number of expired or expiring business-related tax incentives. The major provisions of this Act that affect receipts are described below. The year-by-year effect of these changes (as well as some of the changes provided in the 2001 and 2003 tax cuts) on various provisions of the tax code is shown in Chart 17–1.

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003 and 2004 Tax Cuts

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Individual Income Tax Rates	Rates reduced to 35, 33, 28, and 25 percent								Rates increased to 39.6, 36, 31, and 28 percent
10 Percent Bracket	Top of bracket increased to $7,000/$14,000 for single/joint filers and inflation-indexed								Bracket eliminated, making lowest bracket 15 percent
15 Percent Bracket for Joint Filers	Top of bracket for joint filers increased to 200 percent of top of bracket for single filers								Top of bracket for joint filers reduced to 167 percent of top of bracket for single filers
Standard Deduction for Joint Filers	Standard deduction for joint filers increased to 200 percent of standard deduction for single filers								Standard deduction for joint filers reduced to 167 percent of standard deduction for single filers
Child Credit	Tax credit for each qualifying child under age 17 increased to $1,000								Tax credit for each qualifying child under age 17 reduced to $500
Estate Taxes	Top rate reduced to 49 percent	Top rate reduced to 48 percent Exempt amount increased to $1.5 million	Top Rate reduced to 47 percent	Top rate reduced to 46 percent Exempt amount increased to $2 million	Top rate reduced to 45 percent		Exempt amount increased to $3.5 million	Estate tax repealed	Top rate increased to 60 percent Exempt amount reduced to $1 million

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003 and 2004 Tax Cuts—Continued

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Small Business, Expensing	Deduction increased to $100,000, reduced by amount qualifying property exceeds $400,000, and both amounts inflation-indexed Includes software					Deduction declines to $25,000, reduced by amount qualifying property exceeds $200,000 and amounts not inflation-indexed Does not apply to software			
Capital Gains	Tax rate on capital gains reduced to 5/15 percent					Tax on capital gains eliminated for taxpayers in 10/15 percent tax brackets	Tax rate on capital gains increased to 10/20 percent		
Dividends	Tax rate on dividends reduced to 5/15 percent					Tax on dividends eliminated for taxpayers in 10/15 percent tax brackets	Dividends taxed at standard income tax rates		
Bonus Depreciation	Bonus depreciation increased to 50 percent of qualified property aquired after 5/5/03		Bonus depreciation expires						
Alternative Minimum Tax	AMT exemption amount increased to $40,250/$58,000 for single/joint filers			AMT exemption amount reduced to $33,750/ $45,000 for single /joint filers					

Tax Relief for Families

Extend accelerated expansion of the 10-percent individual income tax rate bracket.—The Economic Growth and Tax Relief Reconciliation Act (2001 tax cut) created a 10-percent individual income tax bracket, which applied to the first $6,000 of taxable income for single taxpayers and married taxpayers filing separate returns (increasing to $7,000 for taxable years beginning after December 31, 2007 and before January 1, 2011), the first $10,000 of taxable income for heads of household, and the first $12,000 of taxable income for married taxpayers filing a joint return (increasing to $14,000 for taxable years beginning after December 31, 2007 and before January 1, 2011). The 2001 tax cut provided for annual inflation adjustments to the width of the 10-percent tax rate bracket, effective for taxable years beginning after December 31, 2008. The Jobs and Growth Tax Relief Reconciliation Act (2003 jobs and growth tax cut) accelerated the expansions of the 10-percent tax rate bracket scheduled to be effective beginning in taxable year 2008, to be effective in taxable years 2003 and 2004. For taxable years beginning after 2004 and before January 1, 2011, the taxable income levels for the 10-percent individual income tax rate bracket were scheduled to revert to the levels provided under the 2001 tax cut. The 2003 jobs and growth tax cut also provided for annual inflation adjustments to the width of the 10-percent tax rate bracket for taxable years beginning in 2004. The 2004 tax relief act extended the expansions of the 10-percent tax rate bracket provided under the 2003 jobs and growth tax cut through taxable year 2007 and provided for continued annual inflation adjustments to the width of 10-percent tax rate bracket for taxable years beginning after 2004. As provided under the 2001 tax cut, the 10-percent tax rate bracket will remain in effect for taxable years 2008 through 2010, and will be eliminated for taxable years beginning after December 31, 2010.

Extend accelerated increase in standard deduction for married taxpayers filing a joint return.—Under the 2001 tax cut, the standard deduction for married taxpayers filing a joint return, which was 167 percent of the standard deduction for unmarried individuals, was increased to double the standard deduction for single taxpayers over a five-year period. Under the phasein, the standard deduction for married taxpayers filing a joint return increased to 174 percent of the standard deduction for single taxpayers in taxable year 2005, 184 percent in taxable year 2006, 187 percent in taxable year 2007, 190 percent in taxable year 2008, and 200 percent in taxable years 2009 and 2010. The 2003 jobs and growth tax cut accelerated the increase in the standard deduction for married taxpayers filing a joint return to 200 percent of the standard deduction for single taxpayers, effective for taxable years 2003 and 2004. For taxable years 2005 through 2010, the standard deduction for married taxpayers filing a joint return was scheduled to revert to the levels provided under the 2001 tax cut. The 2004 tax relief act extended the expanded standard deduction for married taxpayers filing a joint return provided under the 2003 jobs and growth tax cut to apply to taxable years 2005 through 2008. As provided under the 2001 tax cut, the standard deduction for married taxpayers filing a joint return will remain at 200 percent of the standard deduction for single taxpayers in 2009 and 2010, but will decline to 167 percent of the standard deduction for single taxpayers, effective for taxable years beginning after December 31, 2010.

Extend accelerated expansion of the 15-percent individual income tax rate bracket for married taxpayers filing a joint return.—Under the 2001 tax cut, the maximum taxable income in the 15-percent individual income tax rate bracket for married taxpayers filing a joint return, which was 167 percent of the corresponding amount for an unmarried individual, was increased to twice the corresponding amount for unmarried individuals over a four-year period. Under the phasein, the maximum taxable income in the 15-percent tax rate bracket for married taxpayers filing a joint return increased to 180 percent of the corresponding amount for single taxpayers in taxable year 2005, 187 percent in taxable year 2006, 193 percent in taxable year 2007, and 200 percent in taxable years 2008, 2009 and 2010. The 2003 jobs and growth tax cut accelerated the increase in the size of the 15-percent tax rate bracket for married taxpayers filing a joint return to twice the corresponding tax rate bracket for single taxpayers, effective for taxable years 2003 and 2004. For taxable years 2005 through 2010, the size of the 15-percent tax rate bracket for married taxpayers filing a joint return was scheduled to revert to the levels provided under the 2001 tax cut. The 2004 tax relief act extended the expanded 15-percent tax rate bracket for married taxpayers filing a joint return provided under the 2003 jobs and growth tax cut through taxable year 2007. As provided under the 2001 tax cut, the maximum taxable income in the 15-percent tax rate bracket for married taxpayers filing a joint return will remain at twice the corresponding tax rate bracket for single taxpayers in 2008, 2009, and 2010, but will decline to 167 percent of the corresponding amount for single taxpayers, effective for taxable years beginning after December 31, 2010.

Extend accelerated increase in child tax credit.—Under the 2001 tax cut, the maximum amount of the tax credit for each qualifying child under the age of 17 increased from $500 to $1,000 over a period of 10 years, as follows: the credit increased to $600 for taxable years 2001 through 2004, $700 for taxable years 2005 through 2008, $800 for taxable year 2009, and $1,000 for taxable year 2010. The 2003 jobs and growth tax cut accelerated the increase in the credit to $1,000 per child, effective for taxable years 2003 and 2004. For taxable years 2005 through 2010, the credit was scheduled to revert to the levels provided under the 2001 tax cut. The 2004 tax relief act extended the increased credit of $1,000 per child for five years, for taxable years 2005 through 2009. As provided under the 2001 tax cut, the credit will be $1,000 per child for taxable year 2010, but will decline to $500 for taxable years beginning after December 31, 2010.

Accelerate increase in refundability of child tax credit.—Prior to enactment of the 2001 tax cut, taxpayers with three or more qualifying children could be eligible for a refundable additional child tax credit if they had social security taxes, even if they had little or no individual income tax liability. However, taxpayers with one or two children were not eligible for the refundable additional child tax credit. The 2001 tax cut extended eligibility for the refundable credit to taxpayers with one or two children. Under the 2001 tax cut, the additional child tax credit was refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,000 for taxable years 2001 through 2004; the percentage was scheduled to increase to 15 percent for taxable years 2005 through 2010. The $10,000 income threshold was indexed for inflation beginning in 2002. The 2004 tax relief act accelerated to 2004 the increase in refundability to 15 percent that had been scheduled for 2005 under prior law.

Tax Relief for Military Families

Modify treatment of combat pay for purposes of computing the child tax credit and earned income tax crcdit (EITC).—Compensation received by an active member of the Armed Forces for service in a combat zone or while hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone is not included in gross income for tax purposes. The 2004 tax relief act provided that combat pay otherwise excluded from gross income is treated as earned income for purposes of calculating the refundable portion of the child credit, effective for taxable years beginning after December 31, 2003. The 2004 tax relief act also provided that a taxpayer could elect to treat combat pay otherwise excluded from gross income as earned income for purposes of the EITC, effective for taxable years ending after October 4, 2004 and before January 1, 2006.

Alternative Minimum Tax (AMT) Relief for Individuals

Extend AMT exemption amount.—An alternative minimum tax is imposed on individuals to the extent that the tentative minimum tax exceeds the regular tax. An individual's tentative minimum tax generally is equal to the sum of: (1) 26 percent of the first $175,000 ($87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income (taxable income modified to take account of specified preferences and adjustments) in excess of an exemption amount and (2) 28 percent of the remaining excess. The AMT exemption amounts, as provided under the 2003 jobs and growth tax cut, were: (1) $58,000 for married taxpayers filing a joint return and surviving spouses for taxable years 2003 and 2004, declining in 2005 to $45,000; (2) $40,250 for single taxpayers for taxable years 2003 and 2004, declining in 2005 to $33,750; and (3) $29,000 for married taxpayers filing a separate return and estates and trusts, for taxable years 2003 and 2004, declining in 2005 to $22,500. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's alternative minimum taxable income exceeds: (1) $150,000 for married taxpayers filing a joint return and surviving spouses; (2) $112,500 for single taxpayers; and (3) $75,000 for married taxpayers filing a separate return, estates and trusts. The 2004 tax relief act extended for one year, through taxable year 2005, the exemption amounts provided under the 2003 jobs and growth tax cut for taxable years 2003 and 2004. Effective for taxable years beginning after December 31, 2005, the AMT exemption amounts will decline to $33,750 for single taxpayers, $45,000 for married taxpayers filing a joint return and surviving spouses, and $22,500 for married taxpayers filing a separate return and estates and trusts.

Extend ability to offset the AMT with nonrefundable personal credits.—A temporary provision of prior law permitted nonrefundable personal tax credits to offset both the regular tax and the alternative minimum tax for taxable years beginning before January 1, 2004. The 2004 tax relief act extended minimum tax relief for nonrefundable personal credits for two years, to apply to taxable years 2004 and 2005. The extension did not apply to the child credit, the saver credit, or the adoption credit, which were provided AMT relief through December 31, 2010 under the 2001 tax cut.

Tax Simplification

Establish uniform definition of a qualifying child.—The tax code provides assistance to families with children through the dependent exemption, head-of-household filing status, child tax credit, child and dependent care tax credit, and EITC. Under prior law, each provision defined an eligible "child" differently, thereby requiring taxpayers to wade through pages of bewildering rules and instructions, resulting in confusion and error. Under the 2004 tax relief act, effective for taxable years beginning after December 31, 2004, a qualifying child must meet the following three tests: (1) Relationship—The child must be the taxpayer's biological or adopted child, stepchild, sibling, step-sibling, foster child, or a descendant of one of these individuals. (2) Residence—The child must live with the taxpayer in the same principal home in the United States for more than half of the taxable year. (3) Age—The child must be under age 19 (under age 24 in the case of a full-time student), or totally and permanently disabled. However, prior-law requirements that a child be under age 13 for the dependent care credit and under age 17 for the child tax credit, were maintained. Neither the support nor gross income tests of prior law apply to qualifying children who meet these three tests. In addition, taxpayers are no longer required to meet a household maintenance test when claiming the child and dependent care tax credit. Taxpayers generally can continue to claim individuals who do not meet the relationship, residency, or age tests as dependents if they meet the dependency requirements under prior law, and no other taxpayer is eligible to claim the same individual as a qualifying child. A tie-breaking rule applies if a child would be a qualifying child with respect to more than one individual and if more than one individual claims a benefit with respect to that child.

Expiring Provisions

Extend the research and experimentation (R&E) tax credit.—The 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit expired with respect to expenditures incurred after June 30, 2004. The 2004 tax relief act extended these credits for eighteen months, to apply to expenditures incurred before January 1, 2006.

Extend the work opportunity tax credit.—The work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. Under prior law, the credit was available for qualified individuals who began work before January 1, 2004. The 2004 tax relief act extended the credit for two years, to apply to qualified individuals beginning work after December 31, 2003 and before January 1, 2006.

Extend the welfare-to-work tax credit.—The welfare-to-work tax credit provides an incentive for hiring certain recipients of long-term family assistance. The credit is 35 percent of up to $10,000 of eligible wages in the first year of employment and 50 percent of wages up to $10,000 in the second year of employment. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. The 2004 tax relief act extended this credit for two years, to apply to qualified individuals who begin work after December 31, 2003 and before January 1, 2006. Under prior law the credit was available with respect to qualified individuals beginning work before January 1, 2004.

Extend tax incentives for employment and investment on Indian reservations.—The 2004 tax relief act extended for one year, through December 31, 2005, the employment tax credit for qualified workers employed on an Indian reservation and the accelerated depreciation rules for qualified property used in the active conduct of a trade or business within an Indian reservation. The employment tax credit is not available for employees involved in certain gaming activities or who work in a building that houses certain gaming activities. Similarly, property used to conduct or house certain gaming activities is not eligible for the accelerated depreciation recovery periods.

Extend authority to issue Qualified Zone Academy Bonds.—State and local governments are allowed to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds have to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. Under prior law, a nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2003. In addition, unused authority arising in 1998 and 1999 could be carried forward for up to three years and unused authority arising in 2000 through 2003 could be carried forward for up to two years. The 2004 tax relief act authorized the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2004 and 2005; unused authority can be carried forward for up to two years.

Extend authority to issue Liberty Zone Bonds.—The Job Creation and Worker Assistance Act (2002 economic stimulus act) provided authority to issue an aggregate of $8 billion of tax-exempt private activity bonds during calendar years 2002, 2003, and 2004 for the acquisition, construction, reconstruction, and renovation of nonresidential real property, residential rental property, and public utility property in the New York City Liberty Zone. Authority to issue these bonds, which are not subject to the aggregate annual State private activity bond volume limit, was extended through calendar year 2009 under the 2004 tax relief act. The 2004 tax relief act also extended for one year, through December 31, 2005, an expired provision that allowed certain bonds used to finance projects in New York City to be eligible for one additional advance refunding.

Extend the District of Columbia (DC) Enterprise Zone.—The DC Enterprise Zone includes the DC Enterprise Community and District of Columbia census tracts with a poverty rate of at least 20 percent. Businesses in the zone are eligible for: (1) A wage credit equal to 20 percent of the first $15,000 in annual wages paid to qualified employees who reside within the District of Columbia; (2) $35,000 in increased section 179 expensing; and (3) in certain circumstances, tax-exempt bond financing. In addition, a capital gains exclusion is allowed for certain investments held more than five years and made within the DC Zone, or within any District of Columbia census tract with a poverty rate of at least 10 percent. Under prior law, the DC Zone incentives were in effect for the period from January 1, 1998 through December 31, 2003. The 2004 tax relief act extended the DC Zone incentives for two years, through December 31, 2005.

Extend the first-time homebuyer credit for the District of Columbia.—A one-time, nonrefundable $5,000 credit is available to purchasers of a principal residence in the District of Columbia who have not owned a residence in the District during the year preceding the purchase. The credit phases out for taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). Under prior law, the credit did not apply to purchases after December 31, 2003. The credit was extended for two years under the 2004 tax relief act, making it available with respect to purchases after December 31, 2003 and before January 1, 2006.

Extend deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided augmented deductions, not subject to this limitation, for contributions of computer technology and equipment to public libraries and to U.S. schools for educational purposes in grades K-12. The 2004 tax relief act extended the augmented deduction, which expired with respect to donations made after December 31, 2003, to apply to donations made before January 1, 2006.

Extend the above-the-line deduction for qualified out-of-pocket classroom expenses.—Teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceed two percent of adjusted gross income (AGI). Under prior law, certain teachers and other elementary and secondary school professionals were allowed to treat up to $250 in annual qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction), effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2004. Unreimbursed expenditures for certain books, supplies and equipment related to classroom instruction qualified for the above-the-line deduction. Expenses claimed as an above-the-line deduction could not be claimed as an itemized deduction. The 2004 tax relief act extended the above-the-line deduction for two years, to apply to qualified out-of-pocket expenditures incurred after December 31, 2003 and before January 1, 2006.

Extend Archer Medical Savings Accounts (MSAs).—Self-employed individuals and employees of small firms are allowed to establish Archer MSAs; the number of accounts is capped at 750,000. In addition to other requirements: (1) individuals who establish Archer MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,750 but not greater than $2,650 for policies covering a single person and a deductible of at least $3,500 but not greater than $5,250 in all other cases (these amounts are indexed annually for inflation); (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies; and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an Archer MSA for a particular year. Under prior law, no new contributions could be made to an Archer MSA after December 31, 2003, except for the following: (1) those made by or on behalf of individuals who previously had Archer MSA contributions and (2) those made by individuals employed by a participating employer. The 2004 tax relief act extended the Archer MSA program for two years, thereby allowing new Archer MSAs through December 31, 2005.

Extend tax on failure to comply with mental health parity requirements applicable to group health plans.—Under prior law, group health plans that provided both medical and surgical benefits and mental health benefits, could not impose aggregate lifetime or annual dollar limits on mental health benefits that were not imposed on substantially all medical and surgical benefits. An excise tax of $100 per day for each individual affected (during the period of noncompliance) was imposed on an employer sponsoring a group plan that failed to meet these requirements. For a given taxable year, the tax was limited to the lesser of 10 percent of the employer's group health insurance expenses for the prior taxable year or $500,000. The mental health parity requirements expired with respect to benefits for services provided on or after December 31, 2004. The excise tax imposed on plans that failed to meet the requirements expired with respect to benefits for services provided after December 31, 2003. The 2004 tax relief act extended the mental health parity requirements to apply to benefits for services provided before January 1, 2006. The act also extended the excise tax, but only with respect to benefits for services provided after October 3, 2004 and before January 1, 2006. Therefore, the excise tax on failures to meet the mental health parity requirements did not apply to benefits for services provided after December 31, 2003 and before October 4, 2004.

Extend tax credit for the purchase of electric vehicles.—A 10-percent tax credit, up to a maximum of $4,000, is provided for the cost of a qualified electric vehicle. Under prior law, the full amount of the credit was available for purchases prior to January 1, 2004. The credit began to phase down in 2004 and was not available for purchases after December 31, 2006. The 2004 tax relief act extended the full amount of the credit for two years, making it available for purchases in 2004 and 2005. As provided under prior law, the credit is reduced by 75 percent for purchases in 2006 and is not available for purchases after December 31, 2006.

Extend deduction for qualified clean-fuel vehicles and qualified clean-fuel vehicle refueling property.—Under prior law, certain costs of acquiring clean-fuel vehicles (vehicles that use certain clean-burning fuels) and property used to store or dispense clean-burning fuels, could be expensed and deducted when the property was placed in service. For qualified clean-fuel vehicles, the maximum allowable deduction was $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds, $5,000 for a van or truck with a gross weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. The full amount of the deduction could be claimed for vehicles placed in service before January 1, 2004, but began to phase down for vehicles placed in service after December 31, 2003, and was not available after December 31, 2006. The 2004 tax relief act extended the full amount of the deduction for two years, making it available for vehicles placed in service in 2004 and 2005. As provided under prior law, the deduction is reduced by 75 percent for vehicles placed in service in 2006 and is not available for vehicles placed in service after December 31, 2006.

Extend suspension of net income limitation on percentage depletion from marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. Under prior law, for taxable years beginning after December 31, 1997 and before January 1, 2004, domestic oil and gas production from "marginal" properties was exempt from the 100-percent-of-net-income limitation. The 2004 tax relief act extended the exemption to apply to taxable years beginning after December 31, 2003 and before January 1, 2006.

Extend tax credit for producing electricity from certain renewable sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit, the electricity must be sold to an unrelated third party and, under prior law, had to be produced during the first 10 years of production at a facility placed in service before January 1, 2004. The 2004 tax relief act extended the credit for two years, to apply to electricity produced at facilities placed in service before January 1, 2006.

Extend expensing of brownfields remediation costs.—Taxpayers are allowed to elect to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. The 2004 tax relief act extended this provision, which expired with respect to expenditures paid or incurred after December 31, 2003, to apply to expenditures paid or incurred before January 1, 2006.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—Prior law permitted disclosure of tax return information relating to terrorism in two situations. The first was when an executive of a Federal law enforcement or intelligence agency had reason to believe that the return information was relevant to a terrorist incident, threat or activity and submitted a written request. The second was when the Internal Revenue Service (IRS) wished to apprise a Federal law enforcement agency of a terrorist incident, threat or activity. The 2004 tax relief act extended this disclosure authority, which expired on December 31, 2003, through December 31, 2005.

AMERICAN JOBS CREATION ACT OF 2004

The American Jobs Creation Act of 2004 (2004 jobs creation act) was signed by President Bush on October 22, 2004. This Act repealed the extraterritorial income exclusion of prior law, which had been declared a prohibited export subsidy by the World Trade Organization. This Act also provided a deduction against domestic manufacturing income, provided certain tax relief to U.S. businesses and industries, reformed and simplified the taxation of overseas operations of U.S. multinational firms, reformed the Federal tobacco subsidy program, provided a temporary itemized deduction for State and local general sales taxes, and included revenue-raising provisions. The major provisions of this Act that affect receipts are described below.

Extraterritorial Income

Repeal exclusion for extraterritorial income (ETI).—Under the ETI provisions of prior law, certain income attributable to foreign trading gross receipts was excluded from gross income for U.S. tax purposes. The 2004 jobs creation act repealed the ETI provisions, effective for transactions after December 31, 2004. Certain transitional tax rules apply to transactions occurring in 2005 and 2006, providing taxpayers with 80 percent and 60 percent, respectively, of the tax benefit that would have been otherwise allowable under the prior law ETI provisions. Moreover, the ETI provisions of prior law remain in effect for transactions in the ordinary course of a trade or business if such transactions are pursuant to a binding contract between the taxpayer and an unrelated person and the contract was in effect on September 17, 2003 and at all times thereafter.

Provide deduction for domestic manufacturing.—The 2004 jobs creation act provided a deduction equal to a portion of the taxpayer's qualified production activities income, phased in over six years. When fully effective for taxable years beginning after 2009, the deduction would be nine percent (three percent for taxable years 2005 and 2006 and six percent for taxable years 2007, 2008, and 2009) of the lesser of: (1) qualified production activities income for the taxable year; or (2) taxable income (determined without regard to the deduction) for the year. However, the deduction for a taxable year generally is limited to an amount equal to 50 percent of W–2 wages of the employer for the taxable year.

In general, qualified production activities income equals domestic production gross receipts in excess of: (1) the cost of goods sold that are allocable to such receipts; (2) other deductions, expenses, or losses directly allocable to such receipts; and (3) a proper share of other deductions, expenses, and losses that are not directly allocable to such receipts or another class of income. Domestic production gross receipts generally are gross receipts derived from: (1) any sale, lease, rental, license, exchange, or other disposition of (a) qualifying production property (generally any tangible personal property, computer software or sound recordings) manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States; (b) any qualified film produced by the taxpayer (generally any motion picture film or videotape for which 50 percent or more of the total compensation relating to the production of such film is for specified services performed in the United States); and (c) electricity, natural gas, or potable water produced by the taxpayer in the United States; (2) construction activities performed in the United States; or (3) engineering or architectural services performed in the United States for construction projects in the United States. In general, domestic production gross receipts do not include any receipts derived from: (1) the sale of food or beverages prepared at a retail establishment; (2) the transmission or distribution of electricity, natural gas, or potable water; or (3) the leasing, licensing, or rental of property used by a related person.

Business Tax Incentives

Extend temporarily increased expensing for small businesses.—In lieu of depreciation, a small business taxpayer may elect to deduct up to $25,000 of the cost of qualifying property placed in service during the taxable year. Qualifying property includes certain tangible property acquired by purchase for use in the active conduct of a trade or business. The amount that a taxpayer can expense is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $200,000. The deduction is also limited in any taxable year by the amount of taxable income derived from the active conduct by the taxpayer of any trade or business. An election to expense these costs generally must be made on the taxpayer's original return for the taxable year to which the election relates, and can be revoked only with the consent of the IRS Commissioner. Effective for taxable years 2003 through 2005, the 2003 jobs and growth tax cut: (1) increased the maximum deduction to $100,000; (2) increased the annual investment limit to $400,000; (3) expanded the definition of qualifying property to include off-the-shelf computer software; and (4) allowed taxpayers to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The 2003 jobs and growth tax cut also provided for the indexation of the maximum deduction amount and investment limit, effective for taxable years beginning after 2003 and before 2006. The 2004 jobs creation act extended for two years, effective for taxable years 2006 and 2007, the changes provided in the 2003 jobs and growth tax cut.

Modify recovery period for depreciation of certain leasehold improvements.—A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system (MACRS). Under this system, depreciation is determined by applying specified recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Depreciation allowances for improvements made on leased property are determined under MACRS, even if the recovery period assigned to the property is longer than the term of the lease. Therefore, if the leasehold improvement constitutes an addition or improvement to nonresidential real property, the improvement is depreciated using the straight-line method over a 39-year recovery period, beginning at the midpoint of the month the addition or improvement was placed in service. The 2004 jobs creation act reduced the recovery period for qualified leasehold improvement property from 39 years to 15 years, effective for such property placed in service after October 22, 2004 and before January 1, 2006. For purposes of this provision, qualified leasehold improvement property is defined as any improvement to an interior portion of a building that is nonresidential real property: (1) made under or pursuant to a lease either by the lessee (or sublessee) or by the lessor of that portion of the building occupied exclusively by the lessee (or sublessee), and (2) placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.

Modify recovery period for depreciation of certain restaurant improvements.—Under MACRS, the cost of nonresidential real property is depreciated using the straight-line method over a 39-year recovery period. The 2004 jobs creation act reduced the recovery period for qualified restaurant property to 15 years, effective for such property placed in service after October 22, 2004 and before January 1, 2006. For purposes of this provision, qualified restaurant property is defined as any improvement to a building if (1) such improvement is placed in service more than three years after the date such building was first placed in service and (2) more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals.

Modify income forecast method of depreciation.—Under the income forecast method, a property's depreciation deduction for a taxable year is determined by multiplying the adjusted basis of the property (determined before adjustments for depreciation) by a fraction, the numerator of which is the income generated by the property during the year and the denominator of which is the total forecasted or estimated income expected to be generated prior to the close of the tenth taxable year after the year the property was placed in service. Any costs that are not recovered by the end of the tenth taxable year after the property was placed in service may be taken into account as depreciation in such year. The cost of certain motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method. The 2004 jobs creation act stated that, solely for purposes of computing the allowable deduction for property under the income forecast method of depreciation, participations and residuals may be included in the adjusted basis of the property beginning in the year such property is placed in service, but only if such participations and residuals relate to income to be derived from the property before the close of the tenth taxable year following the year the property is placed in service. Participations and residuals are defined as costs the amount of which, by contract, varies with the amount of income earned in connection with such property. This act also stated that: (1) the amount of income from the property to be taken into account under the income forecast method is the gross income from such property (disregarding distribution costs), and (2) on a property-by-property basis, the taxpayer may deduct the costs of participations and residuals as they are paid, rather than accounting for them as a capitalized cost under the income forecast method. These changes were effective for property placed in service after October 22, 2004.

Reform and simplify taxation of S Corporations.—In general, S corporations do not pay Federal income tax. Instead, an S corporation passes through its items of income and loss to its shareholders. Each shareholder separately accounts for his or her share of these items on his or her individual income tax return. A small business corporation (except those designated ineligible under current law) may elect to be an S corporation with the consent of all its shareholders, and may terminate its election with the consent of shareholders holding more than 50 percent of the stock. Under prior law, a small business corporation was defined as a domestic corporation with only one class of stock and no more than 75 shareholders, all of whom were individuals (and certain trusts, estates, charities, and qualified retirement plans) and citizens or residents of the United States. For purposes of the 75 shareholder limitation, a husband and wife were treated as one shareholder. Ineligible small businesses included financial institutions using the reserve method of accounting for bad debts, insurance companies, corporations electing the benefits of the Puerto Rico and possessions tax credit, and Domestic International Sales Corporations (DISCs) or former DISCs. The 2004 jobs creation act contained a number of provisions, generally effective for taxable years beginning after December 31, 2004, that eased S corporation eligibility requirements and affected the tax treatment of some S corporation shareholders. Major changes: (1) increased the limitation on the number of shareholders from 75 to 100; (2) allowed all members of a family to be treated as one shareholder for purposes of the limitation on the number of shareholders; (3) allowed an individual retirement account (IRA) to be a shareholder of a bank S corporation, but only to the extent of stock held on October 22, 2004; (4) provided for the transfer of suspended losses when stock in an S corporation is transferred between spouses or as part of a divorce; and (5) required the filing of information returns by qualified subchapter S subsidiaries.

Repeal certain excise taxes on rail diesel fuel and inland waterway barge fuels.—Under prior law, diesel fuel used in trains and fuels used in barges operating on the designated inland waterways system were subject to a permanent 4.3-cents-per-gallon excise tax that was deposited in the General Fund of the Treasury. Under the 2004 jobs creation act, this tax declined to 3.3 cents per gallon on January 1, 2005, will decline to 2.3 cents per gallon on July 1, 2005, and will be repealed effective January 1, 2007.

Provide tax credit for railroad track maintenance.—The 2004 jobs creation act provided a 50-percent business tax credit for qualified expenditures incurred by eligible taxpayers for railroad track maintenance. The credit, which is effective for expenditures paid or incurred during taxable years beginning after December 31, 2004 and before January 1, 2008, is limited to the product of $3,500 times the number of miles of railroad track owned or leased by an eligible taxpayer as of the close of the taxable year. Qualified expenditures are amounts expended for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by eligible taxpayers. Eligible taxpayers include: (1) certain types of railroads and (2) a person who transports property using the rail facilities of such railroads, or anyone who furnishes railroad-related property or services to such a person.

Suspend temporarily occupational taxes related to distilled spirits, wine and beer.—Special occupational taxes are imposed on producers and others engaged in the marketing of distilled spirits, wine, and beer. These taxes are payable annually, on July 1 of each year. Under the 2004 jobs creation act, these occupational taxes were suspended for the three-year period, July 1, 2005 through June 30, 2008.

Tax Relief for Agriculture and Small Manufacturers

Restructure incentives for alcohol-blended fuels.—Under prior law an income tax credit and an excise tax exemption were provided for ethanol and renewable source methanol used as a fuel. In general, the income tax credit for ethanol was 52 cents per gallon, but small ethanol producers (those producing less than 30 million gallons of ethanol per year) qualified for a credit of 62 cents per gallon on the first 15 million gallons of ethanol produced in a year. A credit of 60 cents per gallon was allowed for renewable source methanol. As an alternative to the income tax credit, blenders of alcohol fuels could claim a gasoline tax exemption of 52 cents for each gallon of ethanol and 60 cents for each gallon of renewable source methanol blended into qualifying gasohol. The rates for the ethanol income tax credit and exemption were each reduced by 1 cent per gallon in 2005. The income tax credit was scheduled to expire on December 31, 2007 and the excise tax exemption was scheduled to expire on September 30, 2007. Neither the credit nor the exemption applied during any period in which motor fuel taxes dedicated to the Highway Trust Fund were limited to 4.3 cents per gallon.

Under prior law, 2.5 cents per gallon of the tax on alcohol-blended fuels was retained in the General Fund of the Treasury, 0.1 cent per gallon was deposited in the Leaking Underground Storage Tank (LUST) Trust Fund, and the balance of the reduced rate was deposited in the Highway Trust Fund.

The incentives for alcohol-blended fuels provided under prior law were restructured under the 2004 jobs creation act. The major changes provided in the act: (1) repealed the gasoline excise tax exemption for most alcohol-blended fuels, thereby levying the full amount of the gasoline excise tax on alcohol-blended fuels sold or used after December 31, 2004; (2) replaced the gasoline excise tax exemption for alcohol-blended fuels with two refundable excise tax credits (the alcohol fuel mixture credit and the biodiesel mixture credit), to be paid from the General Fund of the Treasury rather than from the Highway Trust Fund; (3) provided that the full amount of the excise tax on alcohol-blended fuels (except for the 0.1 cent per gallon deposited in the LUST Trust Fund) is deposited in the Highway Trust Fund, effective for fuels sold or used after September 30, 2004; (4) extended the prior law income tax credit for alcohol-blended fuels through December 31, 2010; and (5) provided a new income tax credit for biodiesel fuel and biodiesel fuel mixtures. The refundable alcohol fuel mixture excise tax credit, effective for fuels sold or used after December 31, 2004 and before January 1, 2011, is 51 cents for each gallon of ethanol (60 cents for each gallon of renewable source methanol) used by a taxpayer in producing an alcohol fuel mixture. The refundable biodiesel mixture excise tax credit, effective for fuels sold or used after December 31, 2004 and before January 1, 2007, is 50 cents for each gallon of biodiesel fuel ($1.00 for each gallon of agri-biodiesel fuel) used by a taxpayer in producing a qualified biodiesel fuel mixture. The income tax credit for biodiesel fuel and biodiesel fuel mixtures is effective for fuels sold or used after December 31, 2004 and before January 1, 2007, and is 50 cents for each gallon of biodiesel fuel ($1.00 for each gallon of agri-biodiesel fuel) that the taxpayer uses as fuel, sells at retail and places in the fuel supply tank of the customer's vehicle, or uses in producing a qualified biodiesel fuel mixture.

Provide tax incentives for agriculture.—The 2004 jobs creation act provided a number of tax incentives to taxpayers engaged in the agriculture business, which included: (1) special rules for the recognition of gain from the sale of livestock sold on account of drought, flood, or other weather-related conditions; (2) modifications allowing the small producer ethanol tax credit to be passed through to members of a cooperative; (3) extension of income averaging to taxpayers engaged in the trade or business of fishing; (4) AMT relief for farmers and fishermen using income averaging; and (5) expensing of up to $10,000 of qualified reforestation expenditures.

Provide tax incentives for small manufacturers.—The 2004 jobs creation act provided a number of tax incentives to small manufacturers, which included: (1) modification of the treatment of net income from publicly traded partnerships as qualifying income for regulated investment companies; (2) simplification of the excise tax imposed on bows and arrows (with further modifications provided in legislation modifying the taxation of arrows and bows signed by the President on December 23, 2004); (3) reduction of the excise tax imposed on fishing tackle boxes from ten percent to three percent; (4) repeal of the three-percent excise tax imposed on sonar devices suitable for finding fish; (5) extension of the placed in service date for bonus depreciation for certain aircraft; (6) expensing and credits allowed with respect to qualifying capital costs incurred by small business refiners in complying with the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency; and (7) modification of the qualified small issue bond capital expenditure limit.

Tax Reform and Simplification for U.S. Business

Modify foreign tax credit.—Subject to various limitations, U.S. taxpayers may credit foreign taxes paid or accrued against U.S. tax on foreign-source income. The 2004 jobs creation act made several changes to the foreign tax credit rules. The major changes included the following:

Modify foreign tax credit carryovers.—Under prior law, the amount of creditable taxes paid or accrued in any taxable year that exceeded the foreign tax credit limitation in that particular year was permitted to be carried back to the two immediately preceding taxable years and carried forward five taxable years and credited to the extent that the taxpayer otherwise had excess foreign tax credit limitation for those years. The 2004 jobs creation act extended the excess foreign tax credit carryforward period to ten years and limited the carryback period to one year. In general, the extended carryforward period is effective for excess foreign taxes that can be carried forward to any taxable year ending after October 22, 2004; the shortened carryback period is effective for excess foreign tax credits arising in taxable years beginning after October 22, 2004.

Modify interest expense allocation rules.—To determine taxable income for foreign tax credit limitation purposes, a taxpayer must allocate and apportion deductions between U.S.-source and foreign-source income. Interest expense of a U.S. affiliated group is allocated and apportioned between U.S.-source and foreign-source income based on the group's total U.S. and foreign assets. All members of a U.S.-affiliated group of corporations generally are treated as a single corporation and allocation of interest expense is made on the basis of the assets of such members, ignoring the debt and interest expense of foreign subsidiaries. The 2004 jobs creation act modified the interest allocation rules by providing a one-time election. Under the election, foreign-source income would be determined by allocating and apportioning interest expense in an amount equal to the excess (if any) of (1) the worldwide affiliated group's total interest expense multiplied by the ratio of foreign assets of the worldwide affiliated group to total assets, over (2) the interest expense of foreign members of the worldwide affiliated group. These changes in the interest expense allocation rules are effective for taxable years beginning after December 31, 2008.

Recharacterize overall domestic loss.—A taxpayer's losses from foreign sources in excess of income from foreign sources (an overall foreign loss, or OFL) may offsets U.S.-source taxable income, thereby reducing the effective tax rate on

U.S.-source income. To address this consequence, to the extent that an OFL offsets U.S.-source taxable income, foreign-source income in succeeding years must be recharacterized as U.S.-source income for foreign tax credit limitation purposes. This OFL recapture rule has the effect of reducing the foreign tax credit limitation in one or more years following an OFL year, thereby reducing the amount of U.S. tax that can be offset by the foreign tax credit in those years. Under prior law, there was no symmetrical treatment for overall domestic losses that offset foreign source income in a taxable year. The 2004 jobs creation act provided that to the extent U.S.-source losses offset foreign-source taxable income, U.S.-source income in succeeding years is recharacterized as foreign-source income for foreign tax credit limitation purposes in a manner similar to the OFL recapture rules. These changes with respect to overall domestic losses are effective for taxable years beginning after December 31, 2006.

Apply look-through approach to dividends paid by a 10/50 company.—Special rules apply in the case of dividends received from a foreign corporation in which the taxpayer owns at least 10 percent of the stock by vote and which is not a controlled foreign corporation (a “10/50 company”). Under prior law, dividends paid by a 10/50 company out of earnings and profits accumulated in taxable years after December 31, 2002 received “look-through” treatment based on the character of the underlying earnings. In contrast, dividends paid by a 10/50 company out of earnings and profits accumulated in taxable years before January 1, 2003 were subject to special basket rules. Effective for taxable years beginning after December 31, 2002, the 2004 jobs creation act generally applied the look-through approach to dividends paid by a 10/50 company, regardless of the year in which the earnings and profits out of which the dividends were paid were accumulated.

Consolidate foreign tax credit categories of income.—Under prior law, the foreign tax credit limitation rules were applied separately for nine statutory limitation categories or “baskets.” Effective for taxable years beginning after December 31, 2006, the 2004 jobs creation act generally reduced the number of foreign tax credit limitation categories from nine to two, with the foreign tax credit limitation rules applied separately to passive income and general income.

Provide AMT relief.—Taxpayers are permitted to reduce their AMT liability by an AMT foreign tax credit. Under prior law, the AMT foreign tax credit was limited to 90 percent of the pre-credit AMT. The 2004 jobs creation act repealed the 90-percent limitation on the use of the AMT foreign tax credit, effective for taxable years beginning after December 31, 2004.

Modify subpart F rules.—Subpart F rules require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation (CFC) to currently include in income for U.S. tax purposes their pro-rata share of the subpart F income of the CFC, whether or not such income is currently distributed to the shareholders. The 2004 jobs creation act made changes to the subpart F rules, generally effective for taxable years beginning after December 31, 2004. Principal changes included the following: (1) The exceptions to the definition of U.S. property were expanded to include: (a) securities acquired and held by a CFC in the ordinary course of its trade or business as a dealer in securities and (b) obligations acquired by the CFC from a U.S. person who is not a domestic corporation and is not a U.S. shareholder of the CFC or a partnership, estate, or trust in which the CFC or any related person is a partner, beneficiary or trustee. (2) In general, the sale of a partnership interest by a CFC would be treated as a sale of a proportionate share of partnership assets attributable to such interest. (3) The requirements for gains or losses on commodities hedging transactions to be excluded from the definition of foreign personal holding company income were modified. (4) The temporary exceptions from foreign personal holding company income and foreign base company services income provided for active financing income were modified. (5) The subpart F rules relating to foreign base company shipping income were repealed, and a safe harbor was provided to treat certain rents derived from leasing an aircraft or vessel in foreign commerce as active income. (6) For purposes of the exception to the definition of U.S. property, “banking business” was defined. In addition, the anti-deferral rules applicable to foreign personal holding companies and to foreign investment companies were repealed; various other anti-deferral rules were consolidated and modified.

Provide incentive to reinvest foreign earnings in the United States.—Income from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income generally is deferred. Under the 2004 jobs creation act, certain dividends received by a U.S. corporation from controlled foreign corporations were provided an 85-percent dividends-received deduction. Various restrictions apply to determine whether dividends are eligible for the deduction, including a requirement that the funds be invested in the United States. At the taxpayer’s election, the deduction is available for dividends received either during the taxpayer’s first taxable year beginning on or after October 22, 2004, or during the taxpayer’s last taxable year beginning before such date. Dividends received after the election period will be taxed in the normal manner under present law.

State and Local General Sales Taxes

Provide optional temporary deduction for State and local general sales taxes.—An itemized deduction is permitted for certain State and local taxes, including individual income taxes, real property taxes, and personal property taxes. Under prior law, a deduction was not provided for State and local general sales taxes (a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items). Under the 2004 jobs creation act, effective for taxable years beginning after December 31, 2003 and before January 1, 2006, a taxpayer would be allowed to elect to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes. The allowable deduction could be determined by tallying the amount of general State and local sales taxes paid on accumulated receipts, or from tables prescribed by the Secretary of the Treasury. A taxpayer tallying the amount of taxes paid would be able to include taxes imposed at one rate on the sale at retail of a broad range of classes of items, as well as taxes imposed at a lower rate on the sale at retail of food, clothing, medical supplies, and motor vehicles. Taxes imposed at a higher rate on the sale of motor vehicles would be deductible, but only up to the amount that would have been imposed at the general sales tax rate. The tables prescribed by the Secretary of the Treasury would be based on the average consumption of taxpayers on a State-by-State basis and would take into account filing status, number of dependents, adjusted gross income, and rates of State and local general sales taxes. Taxpayers who used the tables would be allowed to add to the table amounts general sales taxes paid with respect to purchases of motor vehicles, boats, and other items specified by the Secretary that would not be reflected in the tables.

Tobacco Reform

Reform the tobacco program.—Under prior law, the Federal tobacco program had two main components: a supply management component and a price support component. The supply management component limited and stabilized the quantity of tobacco marketed by farmers through marketing quotas. Because marketing quotas alone could not always guarantee tobacco prices, Federal support prices were established and guaranteed through the mechanism of nonrecourse loans available on each farmer's marketed crop. In 1982 legislation was enacted to ensure that the nonrecourse loan program was run at no-net-cost to the Federal government.

The 2004 jobs creation act repealed all aspects of the Federal tobacco program, effective for crop years beginning in 2005. Under the reformed program, quota holders and producers of quota tobacco (owners, operators, landlords, tenants, or sharecroppers who shared in the risk of production) would be entitled to receive payments in exchange for the termination of the quotas and price supports of prior law. A base quota level would be established for each tobacco quota holder and each producer. Eligible tobacco quota holders would receive $7 per pound on their basic quota allotment, paid in equal installments over 10 years. Eligible producers would receive $1 to $3 per pound, depending on the extent of their quota-related activity in the 2002-2004 marketing years, multiplied by their base quota level, paid in equal installments over 10 years.

Assessments would be imposed quarterly on each manufacturer and importer of tobacco products sold in the United States, effective for fiscal years 2005 through 2014. The assessments, which would be sufficient to fund the payments to quota holders and producers and other expenditures associated with the program, would be based on the class of tobacco product (cigarettes, snuff, chewing tobacco, pipe tobacco, roll-your-own tobacco and cigars) and market share.

Miscellaneous Provisions

Permit stock life insurance companies to make tax-free distributions from policyholder surplus accounts.—Policyholder surplus accounts of stock life insurance companies were established legislatively and represent earnings of such companies that were untaxed under prior law. Any direct or indirect distribution to shareholders from an existing policyholder surplus account of a stock life insurance company is subject to tax at the corporate rate in the taxable year of the distribution. Any distribution to shareholders is treated as made: (1) first out of the shareholder surplus account, to the extent thereof; (2) then out of the policyholder surplus account, to the extent thereof; and (3) finally, out of other accounts. A company may also elect to subtract from its policyholder surplus account any amount as of the close of a taxable year. For stock life insurance companies, the 2004 jobs creation act temporarily suspended the taxation of distributions to shareholders from an existing policyholder surplus account. The act also reversed the order in which distributions reduce the various accounts, so that distributions would be treated as: (1) first made out of the policyholder surplus account, to the extent thereof; (2) then out of the shareholder surplus account, to the extent thereof; and (3) lastly out of other income. These changes were effective for taxable years beginning after December 31, 2004 and before January 1, 2007.

Modify method of accounting for naval shipbuilding contracts.—Taxpayers generally must use the percentage-of-completion method to determine taxable income from long-term contracts. However, an exception exists for certain ship construction contracts, which may be accounted for using the 40/60 percentage-of-completion/capital cost method (PCCM). Under the 40/60 PCCM, 40 percent of the taxpayer's long-term contract income is subject to the percentage-of-completion method, the remaining 60 percent must be reported by consistently using the taxpayer's exempt contract method. Permissible exempt contract methods include the percentage of completion method, the exempt-contract percentage-of-completion method, and the completed contract method. The 2004 jobs creation act allowed qualified naval ship contracts to be accounted for using the 40/60 PCCM during the first five taxable years of the contract. The cumulative reduction in tax resulting from the provision over the five-year period must be recaptured and included in the taxpayer's tax liability in the sixth year. This change was effective for contracts for which construction commenced after October 22, 2004.

Defer gain on the disposition of electric transmission property.—Gain on the sale or other disposition of property is ordinarily recognized in the year of sale. The 2004 jobs creation act permitted the gain from certain sales of electric transmission property to be recognized ratably over eight years beginning with the year of sale, except to the extent proceeds of the sale are not used to purchase replacement utility property. To qualify for this treatment, the transmission property must be sold to an independent transmission company after October 22, 2004 and before January 1, 2007, and the proceeds from the sale must be used to purchase replacement utility property. To the extent the proceeds are not used to purchase replacement utility property, gain is recognized in the year of the sale.

Expand resources eligible for the tax credit for producing electricity from certain sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit under prior law, the electricity had to be sold to an unrelated third party and had to be produced during the first 10 years of production at a qualified facility placed in service before January 1, 2006 and after December 31, 1999 for a poultry waste facility, after December 31, 1992 for a closed-loop biomass facility and after December 31, 1993 for a wind energy facility. Under the 2004 jobs creation act, the credit was expanded to apply to electricity from closed-loop biomass produced at a facility originally placed in service before December 31, 1992 and modified to use closed-loop biomass to co-fire with coal, other biomass, or coal and other biomass before January 1, 2006. The credit for electricity produced by such facilities would be equal to the otherwise allowable credit multiplied by the ratio of the thermal content of the closed-loop biomass fuel burned in the facility to the thermal content of all fuels burned in the facility. The 2004 jobs creation act also expanded the credit to apply to the following new qualifying sources: (1) open-loop biomass (other than agricultural livestock waste nutrients) used at a facility placed in service before January 1, 2006; (2) municipal solid waste, agricultural livestock waste nutrients, geothermal energy, solar energy, small irrigation power, landfill gas, and trash combustion used at a qualifying facility placed in service after October 22, 2004 and before January 1, 2006; and (3) refined coal produced at a qualifying facility placed in service after October 22, 2004 and before January 1, 2009. For facilities using open-loop biomass, including agricultural livestock waste nutrients, geothermal energy, solar energy, small irrigation power, landfill gas, or trash combustion, the credit period was reduced from ten years to five years and (except for geothermal energy and solar energy) the credit rate was reduced by half. Facilities using refined coal could claim the credit at a rate of $4.375 per ton (indexed for inflation).

Revenue Provisions

Modify tax treatment of corporate inversions.—The 2004 jobs creation act addressed "inversion transactions," which occur when a U.S. corporation reincorporates in a foreign jurisdiction and replaces the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. The 2004 jobs creation act included provisions that addressed two types of inversion transactions. These changes generally applied to taxable years ending after March 4, 2003, effective for companies (and certain partnerships) inverting after that date:

> ***Inversions with at least 80 percent identity of stock ownership***.—An inverting company generally would continue to be taxed as a U.S. company (that is, the inversion essentially would be disregarded) if: (1) it acquired substantially all the property of a U.S. corporation, (2) 80 percent or more of its stock was held by former shareholders of the U.S. corporation, and (3) its "expanded affiliated group" did not have substantial business activities in the country in which it was organized.
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> ***Inversions with at least 60 percent (but less than 80 percent) identity of stock ownership***.—Any inversion gain recognized by an inverting U.S. company generally would be taxed and the use of tax attributes such as net operating losses (NOLs) and foreign tax credits would be limited if: (1) it acquired substantially all the property of a U.S. corporation, (2) 60 percent or more of its stock was held by former shareholders of the U.S. corporation and (3) its "expanded affiliated group" did not have substantial business activities in the country in which it was organized.

Revise taxation of individuals who relinquish U.S. citizenship or terminate long-term residency.—An individual who gives up U.S. citizenship or terminates long-term U.S. residency to avoid tax is subject to an alternative tax regime for 10 years following loss of citizenship or termination of residency. The 2004 jobs creation act: (1) eliminated the subjective "principal purpose" standard and established objective standards for determining whether former citizens or long-term residents are subject to the alternative tax regime; (2) provided tax-based rules for determining when an individual is no longer a U.S. citizen or long-term resident; (3) imposed full U.S. taxation on individuals subject to the alternative tax regime who return to the U.S. for extended periods; (4) imposed the U.S. gift tax on gifts of stock of certain closely-held foreign corporations that hold U.S.-situated property; and (5) required individuals subject to the alternative tax regime to file an annual return. These changes applied to individuals who relinquished citizenship or terminated residency after June 3, 2004.

Combat abusive tax avoidance transactions.—Although the vast majority of taxpayers and practitioners do their best to comply with the law, some actively promote or engage in transactions structured to generate tax benefits never intended by Congress. Such abusive transactions harm the public fisc, erode the public's respect for the tax laws, and consume limited IRS resources. The 2004 jobs creation act contained several provisions designed to curtail the use of abusive tax avoidance transactions. The major changes included: (1) the imposition of new or increased penalties on taxpayers who fail to disclose listed or reportable transactions, report an interest in a foreign financial account, or accurately report a listed or reportable transaction; (2) the imposition of new or increased penalties on tax shelter promoters who make false or fraudulent claims to promote abusive tax avoidance transactions, fail to maintain investor lists, or fail to disclose listed or reportable transactions; (3) modification of actions to enjoin conduct related to tax shelters and reportable transactions; (4) expansion of the tax shelter exception for Federal practitioner privilege to apply to all tax shelters; (5) extension of the statute of limitations for unreported listed transactions; and (6) denial of a deduction for interest paid or accrued on any portion of an underpayment of tax attributable to an undisclosed listed transaction or an undisclosed reportable avoidance transaction.

Modify taxation of partnerships.—Although a partnership is a tax-reporting entity that must file an annual partnership return, a partnership does not pay Federal income tax. Instead, income or loss "flows through" to the partners who are each taxed on their distributive share of partnership taxable income. When filing their Federal income tax return, each partner must take into account their distributive share of certain items of partnership income, gain, loss, deduction, or credit. A partner generally is not taxed on distributions of cash or property received from the partnership, except to the extent that any money distributed exceeds the partner's adjusted basis in his partnership interest immediately before the distribution. Taxable gain can also result from distributions of property that were contributed to the partnership with a fair market value in excess of the adjusted basis (property with a built-in gain) and from property distributions characterized as sales and exchanges. The 2004 jobs creation act included several provisions that affect the calculation and allocation of partnership income and ownership interests. The major changes, which generally were applicable with respect to contributions of property, transfers of partnership interests and distributions of partnership property after October 22, 2004, included the following:

Disallow certain partnership loss transfers and modify basis adjustments.—Built-in losses with respect to contributed property would be taken into account only by the contributing partner and not by other partners. In determining the amount of items allocated to partners other than the contributing partner, the basis of the contributed property would be the fair market value at the time of contribution. If the contributing partner's partnership interest were transferred or liquidated, the partnership's adjusted basis in the property would be based on the fair market value at the time of contribution, and the built-in loss would be eliminated.

Modify basis adjustment in stock held by a partnership in a corporate partner.—In applying the basis allocation rules to a distribution in liquidation of a partner's interest, a partnership would be precluded from decreasing the basis of corporate stock of a partner or a related person. Any decrease in basis that would have otherwise been allocated to the stock would be allocated to other partnership assets. If the decrease in basis exceeded the basis of the other partnership assets, then the gain would be recognized by the partnership in the amount of the excess.

Limit the transfer and importation of built-in losses.—The basis of property with a net built-in loss imported into the U.S. in a tax-free incorporation or reorganization from persons not subject to U.S. tax would be its fair market value, thereby eliminating the built-in loss.

Reform the tax treatment for leasing arrangements with tax-indifferent parties.—Certain leasing arrangements (often referred to as sale-in/lease-out or SILO arrangements) involving tax-indifferent parties (including governments, charities, and foreign entities) do not provide financing related to the construction, purchase or refinancing of productive assets. Rather, they involve the payment of an accommodation fee by a U.S. taxpayer to the tax-indifferent party in exchange for the right of the U.S. taxpayer to claim tax benefits from the purported tax ownership of the property. These arrangements usually result in no change in the tax-indifferent party's use or operation of the property, and are designed to ensure that the U.S. taxpayer bears only limited economic risk. The U.S. taxpayer enjoys substantial current tax deductions, while postponing the recognition of taxable income well into the future. The 2004 jobs creation act limited a taxpayer's annual deductions or losses related to a lease with a tax-indifferent party by: (1) modifying the recovery period of certain property (qualified technological equipment, computer software and certain intangibles) leased to a tax-exempt entity to the longer of the property's assigned class life or 125 percent of the lease term; (2) altering the definition of lease term for all property leased to a tax-exempt entity to include the time period a lessee is under a service contract or similar obligation period; and (3) establishing rules to limit deductions associated with such leases to the net income generated from the lease unless the lease meets certain specified criteria. These rules generally were effective with respect to leases entered into after March 12, 2004, and did not apply to short-term leases of five or fewer years, with a modification for short-term leases of qualified technological equipment. Disallowed deductions could be carried forward and treated as deductions related to the lease in the next taxable year, subject to the same limitations, or taken when the taxpayer completely disposed of its interest in the leased property. Indian tribes and their instrumentalities were added to the definition of tax-exempt entities required to depreciate leased property on a straight line basis over a recovery period equal to the longer of the property's assigned class life or 125 percent of the lease term.

Improve tax administration.—A number of provisions included in the 2004 jobs creation act improved tax administration. The major provisions: (1) clarified the rules for payment of estimated tax with respect to tax attributable to a deemed asset sale; (2) clarified that the exclusion for gain on the sale or exchange of a principal residence does not apply in cases where the principal residence was acquired in a like-kind exchange in which any gain was not recognized within the prior five years; (3) allowed taxpayers to deposit cash with the Internal Revenue Service (IRS) that could subsequently be used to pay an underpayment of income, gift, estate, generation-skipping, or certain excise taxes; (4) authorized the IRS to enter into installment agreements that provide for the partial payment of taxes owed; (5) allowed the IRS to levy continuously up to 100 percent of Federal payments to vendors; (6) modified the rules regarding suspension of interest and penalties where the IRS fails to contact the taxpayer; (7) clarified the residence and income source rules relating to U.S. possessions; (8) expanded the prior law provision that disallowed a deduction for interest on certain corporate convertible or equity-linked debt; (9) prevented the mismatching of deductions for accrued interest and original issue discount with their inclusion in income in transactions with related foreign persons; and (10) permitted private collection agencies to engage in specific, limited activities to support IRS collection efforts.

Reduce fuel tax evasion.—A number of provisions included in the 2004 jobs creation act reduced fuel tax evasion. These provisions, which generally were effective after October 22, 2004, included: (1) codification of the exemption from certain excise taxes for mobile machinery vehicles; (2) modification of the definition of an off-highway vehicle; (3) modification of the point of taxation of aviation fuel from the sale by a producer or importer to removal from a refinery or terminal, or entry into the United States; (4) elimination of manual dying of fuel and the imposition of penalties for violation of fuel dying rules; (5) imposition of additional registration requirements on bulk transfers of tax-exempt fuel by pipeline, vessel or barge; (6) repeal of the installment method for payment of the heavy highway vehicle use tax and the elimination of reduced rates for certain heavy highway vehicles; and (7) expansion of taxable fuels to include transmix and diesel fuel blend stocks.

Modify deductions for charitable contributions.—The 2004 jobs creation act made several changes to prior law rules regarding allowable deductions for donations of contributed property. The major changes included the following:

Modify rules for donations of patents and other intellectual property.—In the initial year of a contribution of a patent or other intellectual property (other than certain copyrights or inventory), the allowable deduction would be limited to the lesser of the taxpayer's basis in the donated property or the fair market value of the property. In addition, in that year and in future years, additional amounts could be deducted based on a specified percentage of the amount of royalties or other revenue, if any, actually received by the donee charity from the donated property. These additional deductions would be allowed only to the extent that the aggregate of the amounts calculated exceeded the amount of the deduction claimed in the initial year of the contribution. No additional deductions would be permitted after the expiration of the legal life of the patent or intellectual property, or after the tenth anniversary of the date the contribution was made. This change was effective for contributions made after June 3, 2004.

Limit deductions for charitable contributions of vehicles.—Under prior law, taxpayers generally were permitted to deduct the fair market value of donated vehicles, regardless of whether the vehicle was actually used for a charitable purpose or resold with the charity receiving some revenue from the sale. Under the 2004 jobs creation act, the amount of deduction for charitable contributions of vehicles (generally including automobiles, boats, and airplanes for which the claimed value exceeded $500 and excluding inventory property) would depend upon the use of the vehicle by the donee organization. For vehicles sold by the donee organization without any significant intervening use or material improvement, the amount of the deduction could not exceed the gross proceeds from the sale. Deductions in excess of $500 would have to be substantiated by a contemporaneous written acknowledgement by the donee. Strict penalties would be levied on donee organizations knowingly furnishing false or fraudulent acknowledgements. These changes were effective for contributions made after December 31, 2004.

Require increased reporting for noncash charitable contributions.—Under prior law, any individual, closely-held corporation, personal service corporation, or S corporation claiming a charitable contribution deduction for a contribution of property (other than publicly-traded securities) of more than $5,000 ($10,000 in the case of nonpublicly traded stock) was required to obtain a qualified appraisal for the property. The 2004 jobs creation act extended this requirement to all corporations. In addition, the act required that all taxpayers (whether an individual, a partnership, or a corporation) provide a copy of the appraisal to the IRS for deductions claimed in excess of $500,000. The change was effective for contributions made after June 3, 2004.

Modify treatment of nonqualified deferred compensation plans.—Under prior law, the determination of when amounts deferred under a nonqualified deferred compensation arrangement were includible in the gross income of the individual earning the compensation depended on the facts and circumstances of the arrangement. If the arrangement was unfunded, the compensation generally was includible in income when it was actually or constructively received. If the arrangement was funded, then income was includible for the year in which the individual's rights were transferable or not subject to a substantial risk of forfeiture. Under the 2004 jobs creation act, all amounts deferred under a nonqualified deferred compensation plan are currently includible in the gross income of the individual earning the compensation to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are satisfied. Such requirements include permissible timing for deferral elections and distributions of deferred amounts. If the requirements are not satisfied, interest at the underpayment rate plus one percentage point will be imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. In addition, the amount required to be included in income will be subject to a 20-pecent additional tax. These changes apply with respect to amounts deferred in taxable years beginning after December 31, 2004.

Modify list of taxable vaccines.—A manufacturer's excise tax is imposed at the rate of 75 cents per dose on the following vaccines routinely recommended for administration to children: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, haemophilus influenza type B, hepatitis B, chicken pox, rotavirus gastroenteritis, and streptococcus pneumoniae. The tax applied to any vaccine that is a combination of vaccine components equals 75 cents times the number of components in the combined vaccine. Amounts equal to net revenue from the excise tax are deposited in the Vaccine Injury Compensation Trust Fund to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines. The 2004 jobs creation act added any vaccine against hepatitis A and any trivalent vaccine against influenza to the list of taxable vaccines.

Extend IRS user fees.—The IRS has authority to charge fees for written responses to questions from individuals, corporations, and organizations related to their tax status or the effects of particular transactions for tax purposes. The 2004 jobs creation act extended authority for these fees, which had expired effective with requests made after December 31, 2004, through September 30, 2014.

Establish specific class lives for utility grading costs.—A taxpayer is allowed a depreciation deduction for the exhaustion, wear and tear, and obsolescence of property that is used in a trade or business or held for the production of income. For most tangible property placed in service after 1986, the amount of the depreciation deduction is determined under MACRS using a statutorily prescribed depreciation method, recovery period, and placed in service convention. Under prior law, the cost of initially clearing and grading land improvements were depreciated over a seven-year recovery period under MACRS as assets for which no class life was provided. Under the 2004 jobs creation act, depreciable clearing and grading costs incurred to locate transmission and distribution lines and pipelines were assigned recovery periods of 20 years for electric utilities and 15 years for gas utilities. These changes were effective for property placed in service after October 22, 2004.

Modify treatment of start-up and organizational expenditures.—Under prior law, at the election of the taxpayer, start-up and organizational expenditures could be amortized over a period of not less than 60 months, beginning with the month in which the trade or business began. The 2004 jobs creation act allowed a taxpayer to elect to deduct up to $5,000 of start-up and $5,000 of organizational expenditures in the taxable year in which the trade or business began. However, each $5,000 amount was reduced (but not below zero) by the amount by which the cumulative cost of start-up and organizational expenditures exceeded $50,000, respectively. Start-up and organization expenditures that were not deductible in the year in which the trade or business began would be amortized over a 15-year recovery period. The change was effective for start-up and organizational expenditures incurred after October 22, 2004. Start-up and organizational expenditures incurred on or before October 22, 2004 would continue to be eligible to be amortized over a period not less than 60 months. However, all start-up and organizational expenditures related to a particular trade or business, whether incurred before or after October 22, 2004, would be considered in determining whether the cumulative cost of start-up or organizational expenditures exceeded $50,000.

Limit deduction for certain entertainment expenses.—In general, deductions are not allowed with respect to an activity generally considered to be entertainment, amusement or recreation, unless the taxpayer establishes that the item was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, or a facility (such as an airplane) used in connection with such activity. However, under prior law, this general entertainment expense disallowance rule did not apply to entertainment expenses for goods, services, and facilities to the extent that the expenses were (1) reported by the taxpayer as compensation and wages to an employee, or (2) includible in the gross income of a recipient who was not an employee as compensation for services rendered or as a prize or award. For specified individuals (officers, directors, and 10-percent-or-greater owners of private and publicly-held companies), the 2004 jobs creation act disallowed the deduction, to the extent that such expenses exceeded the amount treated as compensation or includible in income for the individual, with respect to expenses for (1) nonbusiness activity generally considered to be entertainment, amusement or recreation, or (2) a facility used in connection with such activity. This change was effective for such expenses incurred after October 22, 2004.

Limit expensing of sport utility vehicles.—Under prior law, taxpayers purchasing a sport utility vehicle for business use could expense and deduct up to $100,000 of the cost in the year the vehicle was placed in service. The 2004 jobs creation act reduced the amount of expensing allowed with respect to the cost of a sports utility vehicle from $100,000 to $25,000. The change was effective for property placed in service after October 22, 2004.

PENSION FUNDING EQUITY ACT OF 2004

This Act, which was signed by the President on April 10, 2004, made changes to the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code that affect the operation of private pension plans. The major provisions of the Act: (1) established a two-year temporary replacement of the benchmark interest rate for determining funding liabilities of private sector pension plans; (2) established temporary alternative minimum funding standards that reduced funding requirements for commercial airlines, steel companies, and certain other employers; and (3) allowed certain multiemployer plans to temporarily delay the amortization of specified losses. This Act also contained a number of other provisions including: (1) modification of the definition of a property and casualty insurance company and the requirements for such companies to be eligible for tax-exempt status; (2) repeal of the prior law provision requiring reductions in deductions of mutual life insurance companies for policyholder dividends; and (3) extension, through December 31, 2013, of the prior law provision that allowed employers to transfer excess defined benefit plan assets to a special account for health benefits of retirees.

UNITED STATES-AUSTRALIA FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act implemented the U.S.-Australia Free Trade Agreement (FTA), as signed by the United States and Australia on May 18, 2004. The U.S.-Australia FTA advanced U.S. economic interests by providing increased access to Australia's markets for American services, manufactured goods, and agricultural products. The Agreement, which will create jobs and opportunities in both countries, solidified our relationship with an important partner in the global economy and set a strong example of the benefits of free trade and democracy.

UNITED STATES-MOROCCO FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act implemented the U.S.-Morocco FTA, as signed by the United States and Morocco on June 15, 2004. The U.S.-Morocco FTA advanced U.S. economic interests by providing increased access to Morocco's markets for American manufactured goods, agricultural products, services, and investment. The Agreement provided a significant opportunity to encourage economic reform and development in a moderate Muslim nation and was an important step in implementing the President's plan for a broader U.S.-Middle East Free Trade Area.

THE AGOA ACCELERATION ACT OF 2004

The African Growth and Opportunity Act (AGOA), enacted in May 2000, reduced barriers to trade, thereby increasing exports, creating jobs, and increasing opportunities for Africans and Americans alike. It gave American businesses greater confidence to invest in Africa, and encouraged African nations to reform their economies and governments to take advantage of the opportunities that AGOA provided. The AGOA Acceleration Act, which was signed by the President on July 13, 2004, built on that success by extending trade preferences for certain imports from designated sub-Saharan African countries through September 30, 2015. The deadline for expiration of these benefits had been September 30, 2008 under prior law. The AGOA Acceleration Act also extended the prior law deadline for use of third country fabric benefits from September 30, 2004 to September 30, 2007. Under this provision, any AGOA country with a per capita GNP less than $1,500 enjoys duty-free access (subject to caps on the amount of imports as measured by square meter equivalents) to the U.S. market for apparel made from fabric originating anywhere in the world. This Act also expanded benefits by modifying rules of origin for certain apparel components, such as collars and cuffs, and expanded the scope of eligible goods to include ethnic fabrics made on machines, rather than just those made by hand.

THE MISCELLANEOUS TRADE AND TECHNICAL CORRECTIONS ACT OF 2004

This Act, which was signed by the President on December 3, 2004, provided for the temporary suspension of tariffs on about 330 new items, including a wide variety of chemicals, and a number of pigments and dyes that are for the most part not made in the U.S. and needed by U.S. manufacturers. This Act also extended suspensions of tariffs on a number of items, refunded tariffs on specified imports, and made technical corrections to several trade laws.

ADMINISTRATION PROPOSALS

REFORM THE FEDERAL TAX SYSTEM

On January 7, 2005, the President established an Advisory Panel on Federal Tax Reform to develop options to improve the tax system. The current tax system is complex, is perceived by many as unfair, and distorts household and business decisions. The excessive time taxpayers spend to understand and comply with the tax system is a burden and wastes resources. Taxpayers spend an estimated six billion hours to comply with the tax system at a cost of more than $100 billion annually. Individuals and businesses need a tax system that is simpler, and easier to understand and comply with. Faith in the fairness of our tax system is undermined when taxpayers believe others can exploit the complexities of the law to avoid paying tax. At the same time, Americans deserve a tax code that will allow them to make decisions based more on economic merit, free of the distortions generated by the tax system. The economic costs associated with these distortions can total hundreds of billions of dollars annually.

The Advisory Panel will broadly focus on revenue-neutral reforms that make the tax system simpler, encourage economic growth, and promote fairness, while recognizing the importance of homeownership and charitable giving in American society. Information on the Advisory Panel and its deliberations can be found at www.taxreformpanel.gov. The Advisory Panel will provide options for reforming the tax system to the Secretary of the Treasury no later than July 31, 2005. These options will help the Treasury Secretary and others within the Administration develop specific recommendations for the President.

Pending the outcome of fundamental tax reform, the President will continue to propose important policy initiatives including permanent extension of the increased expensing for small businesses and the reductions in taxes on capital gains and dividends provided in the 2003 jobs and growth tax cut. The President's policy initiatives also include permanent extension of the provisions of the 2001 tax cut scheduled to sunset on December 31, 2010, permanent extension of the research and experimentation tax credit, and extension of many other expiring provisions. In addition, the President's initiatives include incentives for charitable giving, strengthening education, investing in health care, protecting the environment, increasing energy production, and promoting energy conservation.

This Budget also includes proposals designed to increase opportunities for saving by simplifying and rationalizing the many tax preferred savings vehicles provided under current law, improve tax compliance, curtail abusive tax avoidance activities, and strengthen the employer-based pension system.

MAKE PERMANENT CERTAIN TAX CUTS ENACTED IN 2001 AND 2003

Extend permanently reductions in individual income taxes on capital gains and dividends.—The maximum individual income tax rate on net capital gains and dividends is 15 percent for taxpayers in individual income tax rate brackets above 15 percent and 5 percent (zero in 2008) for lower income taxpayers. The Administration proposes to extend permanently these reduced rates (15 percent and zero), which are scheduled to expire on December 31, 2008.

Extend permanently increased expensing for small business.—Small business taxpayers are allowed to expense up to $100,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years 2003 through 2007. The amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2008. Also, with respect to a taxable year beginning after 2002 and before 2008, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to extend permanently each of these temporary provisions, applicable for qualifying property (including off-the-shelf computer software) placed in service in taxable years beginning after 2007.

Extend permanently provisions expiring in 2010.—Most of the provisions of the 2001 tax cut sunset on December 31, 2010. The Administration proposes to extend those provisions permanently.

TAX INCENTIVES

Simplify and Encourage Saving

Expand tax-free savings opportunities.—Under current law, individuals can contribute to traditional Individual Retirement Accounts (IRAs), nondeductible IRAs, and Roth IRAs, each subject to different sets of rules. For example, contributions to traditional IRAs are deductible, while distributions are taxed; contributions to Roth IRAs are taxed, but distributions are excluded from income. In addition, eligibility to contribute is subject to various age and income limits. While primarily intended for retirement saving, withdrawals for certain education, medical, and other non-retirement expenses are penalty free. The eligibility and withdrawal restrictions for these accounts complicate compliance and limit incentives to save.

The Administration proposes to replace current law IRAs with two new savings accounts: a Lifetime Savings Account (LSA) and a Retirement Savings Account (RSA). Regardless of age or income, individuals could make annual nondeductible contributions of $5,000 to an LSA and $5,000 (or earnings if less) to an RSA. Distributions from an LSA would be excluded from income and could be made at anytime for any purpose without restriction. Distributions from an RSA would be excluded from income after attaining age 58 or in the event of death or disability. All other distributions would be included in income (to the extent they exceed basis) and subject to an additional tax. Distributions would be deemed to come from basis first. The proposal would be effective for contributions made after December 31, 2005 and future year contribution limits would be indexed for inflation.

Existing Roth IRAs would be renamed RSAs and would be subject to the new rules for RSAs. Existing traditional and nondeductible IRAs could be converted into an RSA by including the conversion amount (excluding basis) in gross income, similar to a current-law Roth conversion. However, no income limit would apply to the ability to convert. Taxpayers who convert IRAs to RSAs could spread the included conversion amount over several years. Existing traditional or nondeductible IRAs that are not converted to RSAs could not accept new contributions. New traditional IRAs could be created to accommodate rollovers from employer plans, but they could not accept new individual contributions. Individuals wishing to roll an amount directly from an employer plan to an RSA could do so by including the rollover amount (excluding basis) in gross income (i.e., "converting" the rollover, similar to a current law Roth conversion).

Saving will be further simplified and encouraged by administrative changes already planned for the 2007 filing season that will allow taxpayers to have their tax refunds directly deposited into more than one account. Consequently, taxpayers will be able, for example, to direct that a portion of their tax refunds be deposited into an LSA or RSA.

Consolidate employer-based savings accounts.—Current law provides multiple types of tax-preferred employer-based savings accounts to encourage saving for retirement. The accounts have similar goals but are subject to different sets of rules regulating eligibility, contribution limits, tax treatment, and withdrawal restrictions. For example, 401(k) plans for private employers, SIMPLE 401(k) plans for small employers, 403(b) plans for 501(c)(3) organizations and public schools, and 457 plans for State and local governments are all subject to different rules. To qualify for tax benefits, plans must satisfy multiple requirements. Among the requirements, the plan generally may not discriminate in favor of highly compensated employees with regard either to coverage or to amount or availability of contributions or benefits. Rules covering employer-based savings accounts are among the lengthiest and most complicated sections of the tax code and associated regulations. This complexity imposes substantial costs on employers, participants, and the government, and likely has inhibited the adoption of retirement plans by employers, especially small employers.

The Administration proposes to consolidate 401(k), SIMPLE 401(k), 403(b), and 457 plans, as well as SIMPLE IRAs and SARSEPs, into a single type of plan—Employee Retirement Savings Accounts (ERSAs)—that would be available to all employers. ERSA non-discrimination rules would be simpler and include a new ERSA non-discrimination safe-harbor. Under one of the safe-harbor options, a plan would satisfy the nondiscrimination rules with respect to employee deferrals and employee contributions if it provided a 50-percent match on elective contributions up to six percent of compensation. By creating a simplified and uniform set of rules, the proposal would substantially reduce complexity. The proposal would be effective for taxable years beginning after December 31, 2005.

Establish Individual Development Accounts (IDAs).—The Administration proposes to allow eligible individuals to make contributions to a new savings vehicle, the Individual Development Account, which would be set up and administered by qualified financial institutions, nonprofit organizations, or Indian tribes (qualified entities). Citizens or legal residents of the United States between the ages of 18 and 60 who cannot be claimed as a dependent on another taxpayer's return, are not students, and who meet certain income limitations would be eligible to establish and contribute to an IDA. A single taxpayer would be eligible to establish and contribute to an IDA if his or her modified AGI in the preceding taxable year did not exceed $20,000 ($30,000 for heads of household, and $40,000 for married taxpayers filing a joint return). These thresholds would be indexed annually for inflation beginning in 2008. Qualified entities that set up and administer IDAs would be required to match, dollar-for-dollar, the first $500 contributed by an eligible individual to an IDA in a taxable year. Qualified entities would be allowed a 100 percent tax credit for up to $500 in annual matching contributions to each IDA, and a $50 tax credit for each IDA maintained at the end of a taxable year with a balance of not less that $100 (excluding the taxable year in which the account was established). Matching contributions and the earnings on those contributions would be deposited in a separate "parallel account." Contributions to an IDA by an eligible individual would not be deductible, and earnings on those contributions would be included in income. Matching contributions by qualified entities and the earnings on those contributions would be tax-free.

Withdrawals from the parallel account may be made only for qualified purposes (higher education, the first-time purchase of a home, business start-up, and qualified rollovers). Withdrawals from the IDA for other than qualified purposes may result in the forfeiture of some or all matching contributions and the earnings on those contributions. The proposal would be effective for contributions made after December 31, 2006 and before January 1, 2014, to the first 900,000 IDA accounts opened before January 1, 2012.

Invest in Health Care

Provide a refundable tax credit for the purchase of health insurance.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of adjusted gross income (AGI), the individual has self-employment income, or the individual is eligible under the Trade Act of 2002 to purchase certain types of qualified health insurance. In addition, individuals are allowed to accumulate funds in a health savings account (HSA) or medical savings account (MSA) on a tax-preferred basis to pay for medical expenses, provided they are covered by an HSA high-deductible health plan (and no other health plan). The Administration proposes to make health insurance more affordable for individuals not covered by an employer plan or a public program. Effective for taxable years beginning after December 31, 2005, a new refundable tax credit would be provided for the cost of health insurance purchased by individuals under age 65. The credit would provide a subsidy for a percentage of the health insurance premium, up to a maximum includable premium. The maximum subsidy percentage would be 90 percent for low-income taxpayers and would phase down with income. The maximum credit would be $1,000 for an adult and $500 for a child. The credit would be phased out at $30,000 for single taxpayers and $60,000 for families purchasing a family policy.

If the health insurance qualifies as an HSA high-deductible health plan, an individual may opt to contribute 30 percent of the credit to a special HSA that could only be used to pay for medical expenses. Individuals could claim the tax credit for health insurance premiums paid as part of the normal tax-filing process. Alternatively, beginning July 1, 2007, the tax credit would be available in advance at the time the individual purchases health insurance. The advance credit would reduce the premium paid by the individual to the health insurer, and the health insurer would be reimbursed directly by the Department of Treasury for the amount of the advance credit. Eligibility for an advance credit would be based on an individual's prior year tax return. To qualify for the credit, a health insurance policy would have to include coverage for catastrophic medical expenses. Qualifying insurance could be purchased in the individual market. Qualifying health insurance could also be purchased through private purchasing groups, State-sponsored insurance purchasing pools, and high-risk pools. Such groups may make purchasing health insurance easier and help reduce health insurance costs and increase coverage options for individuals, including older and higher-risk individuals.

Provide an above-the-line deduction for high-deductible insurance premiums.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI, the individual has self-employment income, or the individual is eligible under the Trade Act of 2002 to purchase certain types of qualified health insurance. Current law also allows individuals to accumulate funds in an HSA or MSA on a tax-preferred basis to pay for medical expenses, provided they are covered by a high-deductible health plan (and no other health plan). The Administration proposes to allow individuals who contribute to an HSA because they are covered under an HSA high-deductible health plan in the individual insurance market to deduct the amount of the premium in determining AGI (whether or not the person itemizes deductions). Individuals claiming other credits or deductions or covered by employer plans, public plans or otherwise not eligible to contribute to an HSA would not qualify. The provision would be effective to taxable years beginning after December 31, 2005.

Provide a refundable tax credit for contributions of small employers to employee HSAs.—Under current law, employers are provided a deduction for the cost of health coverage provided to employees and the value of that coverage is not subject to tax for the employees. Nevertheless, many American workers in small firms are currently without health coverage. In order to provide an incentive to small employers to sponsor group health coverage, especially high-deductible health coverage that encourages cost consciousness, the Administration proposes to provide a refundable tax credit for employer contributions to employee HSA accounts of up to $200 for single coverage and up to $500 for family coverage. The subsidy would be provided to for-profit employers that normally employ fewer than 100 employees. The employer would be required to maintain a high-deductible health plan (as defined for purposes of the HSA) accessible to all employees, but the employer would not be required to make contributions toward employees' premiums under the plan. The employer would not be entitled to a deduction for the amount reimbursed by the credit and the credit could not be carried back or carried forward. The amount of the employer contribution to the HSA for which a credit is claimed would be maintained in a special HSA that would be subject to the rules currently applicable to HSAs, except that withdrawals in excess of qualified medical expenses would subject the HSA owner to a tax equal to 100 percent of the amount of the withdrawal. Sole proprietors, partners and S-corporation shareholders would be eligible for the credit to the extent their business is a small employer or has no employees. However, self-employed individuals would not be entitled to any deductions for the amount reimbursed by the credit. The HSA tax credit would be effective for taxable years beginning after December 31, 2005.

Improve the Health Coverage Tax Credit.—The Health Coverage Tax Credit (HCTC) was created under the Trade Act of 2002 for the purchase of qualified health insurance. Eligible persons include certain individuals who are receiving benefits under the TAA or the Alternative TAA (ATAA) program and certain individuals between the ages of 55 and 64 who are receiving pension benefits from the Pension Benefit Guaranty Corporation (PBGC). The tax credit is refundable and can be claimed through an advance payment mechanism at the time the insurance is purchased. To make the requirements for qualified State-based coverage under the HCTC more consistent with the rules applicable under the Health Insurance Portability and Accountability Act (HIPAA) and thus encourage more plans to participate in the HCTC program, the Administration proposes to allow State-based coverage to impose a pre-existing condition restriction for a period of up to 12 months, provided the plan reduces the restriction period by the length of the eligible individual's creditable coverage (as of the date the individual applied for the State-based coverage). This provision would be effective for eligible individuals applying for coverage after December 31, 2005. Also, in order to prevent an individual from losing the benefit of the HCTC just because his or her spouse becomes eligible for Medicare, the Administration proposes to permit spouses of HCTC-eligible individuals to claim the HCTC when the HCTC-eligible individual becomes entitled to Medicare coverage. The spouse, however, would have to be at least 55 years old and meet the other HCTC eligibility requirements. This provision would be effective for taxable years beginning after December 31, 2005. Finally, to improve the administration of the HCTC, the Administration proposes to: (1) modify the definition of "other specified coverage" for "eligible ATAA recipients," to be the same as the definition applied to "eligible TAA recipients;" (2) clarify that certain PBGC pension recipients are eligible for the tax credit; (3) allow State-based continuation coverage to qualify without meeting the requirements for State-based qualified coverage; (4) for purposes of the State-based coverage rules, permit the Commonwealths of Puerto Rico and Northern Mariana Islands, as well as American Samoa, Guam, and the U.S. Virgin Islands to be deemed as States; and (5) clarify the application of the confidentiality and disclosure rules to the administration of the advance credit.

Allow the orphan drug tax credit for certain pre-designation expenses.—Current law provides a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions ("orphan drugs"). A taxpayer may claim the credit only for expenses incurred after the Food and Drug Administration (FDA) designates a drug as a potential treatment for a rare disease or condition. This creates an incentive to defer clinical testing for orphan drugs until the taxpayer receives the FDA's approval and increases complexity for taxpayers by treating pre-designation and post-designation clinical expenses differently. The Administration proposes to allow taxpayers to claim the orphan drug credit for expenses incurred prior to FDA designation if designation occurs before the due date (including extensions) for filing the tax return for the year in which the FDA application was filed. The proposal would be effective for qualified expenses incurred after December 31, 2004.

Provide Incentives for Charitable Giving

Permit tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Effective for distributions after date of enactment, the Administration proposes to allow individuals who have attained age 65 to exclude from gross income IRA distributions made directly to a charitable organization. The exclusion would apply without regard to the percentage-of-AGI limitations that apply to deductible charitable contributions. The exclusion would apply only to the extent the individual receives no return benefit in exchange for the transfer, and no charitable deduction would be allowed with respect to any amount that is excludable from income under this provision.

Expand and increase the enhanced charitable deduction for contributions of food inventory.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one half of the fair market value in excess of basis, or (2) two times basis. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

Under the Administration's proposal, which is designed to encourage contributions of food inventory to charitable organizations, any taxpayer engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory. The enhanced deduction for donations of food inventory would be increased to the lesser of: (1) fair market value or (2) two times basis. However, to ensure consistent treatment of all businesses claiming an enhanced deduction for donations of food inventory, the enhanced deduction for qualified food donations by S corporations and non-corporate taxpayers would be limited to 10 percent of net income from the trade or business. A special provision would allow taxpayers with a zero or low basis in the qualified food donation (e.g., taxpayers that use the cash method of accounting for purchases and sales, and taxpayers that are not required to capitalize indirect costs) to assume a basis equal to 25 percent of fair market value. The enhanced deduction would be available only for donations of "apparently wholesome food" (food intended for human consumption that meets all quality and labeling standards imposed by Federal, state, and local laws and regulations, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions). The fair market value of "apparently wholesome food" that cannot or will not be sold solely due to internal standards of the taxpayer or lack of market, would be determined by taking into account the price at which the same or substantially the same food items (as to both type and quality) are sold by the taxpayer at the time of the contribution or, if not sold at such time, in the recent past. These proposed changes in the enhanced deduction for donations of food inventory would be effective for taxable years beginning after December 31, 2004.

Reform excise tax based on investment income of private foundations.—Under current law, private foundations that are exempt from Federal income tax are subject to a two-percent excise tax on their net investment income (one-percent if certain requirements are met). The excise tax on private foundations that are not exempt from Federal income tax, such as certain charitable trusts, is equal to the excess of the sum of the excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. To encourage increased charitable activity and simplify the tax laws, the Administration proposes to replace the two rates of tax on the net investment income of private foundations that are exempt from Federal income tax with a single tax rate of one percent. The excise tax on private foundations not exempt from Federal income tax would be equal to the excess of the sum of the one-percent excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax what would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The proposed change would be effective for taxable years beginning after December 31, 2004.

Modify tax on unrelated business taxable income of charitable remainder trusts.—A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A trust does not qualify as a charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the value of the remainder interest in the trust is at least 10 percent of the value of the assets contributed to the trust. Distributions from a charitable remainder annuity trust or charitable remainder unitrust, which are included in the income of the beneficiary for the year that the amount is required to be distributed, are treated in the following order as: (1) ordinary income to the extent of the trust's undistributed ordinary income for that year and all prior years; (2) capital gains to the extent of the trust's undistributed capital gain for that year and all prior years; (3) other income to the extent of the trust's undistributed other income for that year and all prior years; and (4) corpus (trust principal).

Charitable remainder annuity trusts and charitable remainder unitrusts are exempt from Federal income tax; however, such trusts lose their income tax exemption for any year in which they have unrelated business taxable income. Any taxes imposed on the trust are required to be allocated to trust corpus. The Administration proposes to levy a 100-percent excise tax on the unrelated business taxable income of charitable remainder trusts, in lieu of removing the Federal income tax exemption for any year in which unrelated business taxable income is incurred. This change, which is a more appropriate remedy than loss of tax exemption, is proposed to become effective for taxable years beginning after December 31, 2004, regardless of when the trust was created.

Modify basis adjustment to stock of S corporations contributing appreciated property.—Under current law, each shareholder in an S corporation separately accounts for his or her pro rata share of the S corporation's charitable contributions in determining his or her income tax liability. A shareholder's basis in the stock of the S corporation must be reduced by the amount of his or her pro rata share of the S corporation's charitable contribution. In order to preserve the benefit of providing a charitable contribution deduction for contributions of appreciated property and to prevent the recognition of gain on the contributed property on the disposition of the S corporation stock, the Administration proposes to allow a shareholder in an S corporation to increase his or her basis in the stock of an S corporation by an amount equal to the excess of the shareholder's pro rata share of the S corporation's charitable contribution over the stockholder's pro rata share of the adjusted basis of the contributed property. The proposal would be effective for taxable years beginning after December 31, 2004.

Repeal the $150 million limitation on qualified 501(c)(3) bonds.—Current law contains a $150 million limitation on the volume of outstanding, non-hospital, tax-exempt bonds for the benefit of any one 501(c)(3) organization. The limitation was repealed in 1997 for bonds issued after August 5, 1997, at least 95 percent of the net proceeds of which are used to finance capital expenditures incurred after that date. However, the limitation continues to apply to bonds more than five percent of the net proceeds of which finance or refinance working capital expenditures, or capital expenditures incurred on or before August 5, 1997. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the $150 million limitation in its entirety.

Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property.—Tax-exempt, 501(c)(3) organizations generally may utilize tax-exempt financing for charitable purposes. However, existing law contains a special limitation under which 501(c)(3) organizations may not use tax-exempt financing to acquire existing residential rental property for charitable purposes unless the property is rented to low-income tenants or is substantially rehabilitated. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the residential rental property limitation.

Strengthen Education

Extend, increase, and expand the above-the-line deduction for qualified out-of-pocket classroom expenses.—Under current law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceeded two percent of AGI. Current law also allows certain teachers and other elementary and secondary school professionals to treat up to $250 in annual qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction). This additional deduction is effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2006. Unreimbursed expenditures for certain books, supplies, and equipment related to classroom instruction qualify for the above-the-line deduction. Expenses claimed as an above-the-line deduction may not be claimed as an itemized deduction. The Administration proposes to extend the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred in taxable years beginning after December 31, 2005, to increase the deduction to $400, and to expand the deduction to apply to unreimbursed expenditures for certain professional training programs.

Encourage Telecommuting

Exclude from income the value of employer-provided computers, software, and peripherals.—Under current law, the value of computers and related equipment and services provided by an employer to an employee for home use is generally allocated between business and personal use. The business-use portion is excluded from the employee's income whereas the personal-use portion is subject to income and payroll taxes. In order to simplify recordkeeping, improve compliance, and encourage telecommuting, the Administration proposes to allow individuals to exclude from income the value of employer-provided computers and related equipment and services necessary to perform work for the employer at home. The employee would be required to make substantial use of the equipment to perform work for the employer. Substantial business use would include standby use for periods when work from home may be required by the employer, such as during work closures caused by the threat of terrorism, inclement weather, or natural disasters. The proposal would be effective for taxable years beginning after December 31, 2005.

Provide Assistance to Distressed Areas

Establish Opportunity Zones.—The Administration proposes to establish authority to designate 40 opportunity zones (28 in urban areas and 12 in rural areas). The zone designation and corresponding incentives would be in effect from January 1, 2006 through December 31, 2015. To qualify to apply for zone status, a community must either have suffered from a significant decline in its economic base over the past decade as measured by the loss of manufacturing and retail establishments and manufacturing jobs, or be an existing empowerment zone, renewal community or enterprise community. The Secretary of Commerce would select opportunity zones through a competitive process based on the applicant's "community transition plan" and "statement of economic transition." The community transition plan would have to set concrete, measurable goals for reducing local regulatory and tax barriers to construction, residential development and business creation. The statement of economic transition would have to demonstrate that the local community's economic base is in transition, as indicated by a declining job base and labor force, and other measures, during the past decade. In evaluating applications, the Secretary of Commerce could consider other factors, including: (1) changes in unemployment rates, poverty rates, household income, homeownership and labor force participation; (2) the educational attainment and average

age of the population; and (3) for urban areas, the number of mass layoffs occurring in the area's vicinity over the previous decade. Empowerment zones and renewal communities designated as opportunity zones would not count against the limitation of 40 new opportunity zones. Such communities would be required to relinquish their current status and benefits once selected. Opportunity zone benefits for converted empowerment zones and renewal communities would expire on December 31, 2009. Tax benefits for enterprise communities expired at the end of 2004. Enterprise communities designated as opportunity zones would count against the limitation of 40 new zones and opportunity zone benefits would be in effect through 2015.

A number of tax incentives would be applicable to opportunity zones. First, a business would be allowed to exclude 25 percent of its taxable income if it qualified as an "opportunity zone business" and it satisfied a $5 million gross receipts test. The definition of an opportunity zone business would be based on the definition of a "qualified active low-income community business" for purposes of the new markets tax credit, treating opportunity zones as low-income communities. Second, an opportunity zone business would be allowed to expense the cost of section 179 property that is qualified zone property, up to an additional $100,000 above the amounts generally available under current law. Third, a commercial revitalization deduction would be available for opportunity zones in a manner similar to the deduction for renewal communities. A $12 million annual cap on these deductions would apply to each opportunity zone. Finally, individuals who live and work in an opportunity zone would constitute a new target group with respect to wages earned within the zone under the proposed combined work opportunity tax credit and welfare-to-work tax credit (see discussion later in this Chapter).

Provide Disaster Relief

***Provide tax relief for Federal Emergency Management Agency (FEMA) hazard mitigation assistance programs*.**—The Federal Emergency Management Agency's mitigation assistance programs provide grants through State and local governments to businesses and individuals for cost-effective responses to natural hazards. FEMA may make grants in the aftermath of a major disaster, in anticipation of a natural hazard, or in areas of severe repetitive loss. Grants may fund demolition, retro-fitting, elevation, or other measures to reduce the cost of future property damage. Under current tax law, gross income includes governmental disaster payments unless they fall into certain exceptions that generally provide for relief with respect to damages or expenses incurred, but would not encompass payments to mitigate future damage. Tax relief is warranted to the extent that property owners may decline to participate in mitigation assistance programs because of the potential tax obligation. The Administration proposes to exclude FEMA mitigation grants from gross income. To prevent a double benefit, a business that receives a tax-free mitigation grant and uses the grant to purchase or repair property could not claim a deduction for those expenses. The exclusion would apply only to FEMA mitigation grants, and not to any compensation from a mitigation assistance program for the acquisition of property situated in a disaster or hazard area. However, if FEMA acquires property, and the owner replaces the property within a specified period, then instead of reflecting the compensation in gross income, the owner would have a carry-over cost basis in the replacement property. If a mitigation assistance program pays the cost of improving property, the cost would be excluded from gross income, but there would be no increase in the owner's cost basis in the property. Thus, if the property is later sold, any resulting gain potentially would be taxable. The proposal generally would be effective for mitigation assistance received after December 31, 2004, but the Department of Treasury would have administrative authority to provide retroactive relief.

Increase Housing Opportunities

***Provide tax credit for developers of affordable single-family housing*.**—The Administration proposes to provide annual tax credit authority to states (including U.S. possessions) designed to promote the development of affordable single-family housing in low-income urban and rural neighborhoods. Beginning in calendar year 2006, first-year credit authority equal to the amount provided for low-income rental housing tax credits would be made available to each state. That amount was equal to the greater of $2.075 million or $1.80 per capita for 2004, and is indexed annually for inflation. State housing agencies would award first-year credits to single-family housing units comprising a project located in a census tract with median income equal to 80 percent or less of area median income. Units in condominiums and cooperatives could qualify as single-family housing. Credits would be awarded as a fixed amount for individual units comprising a project. The present value of the credits, determined on the date of a qualifying sale, could not exceed 50 percent of the cost of constructing a new home or rehabilitating an existing property. The taxpayer (developer or investor partnership) owning the housing unit immediately prior to the sale to a qualified buyer would be eligible to claim credits over a five-year period beginning on the date of sale. Eligible homebuyers would be required to have incomes equal to 80 percent or less of area median income. Certain technical features of the provision would follow similar features of current law with respect to the low-income housing tax credit and mortgage revenue bonds.

Protect the Environment

***Extend permanently expensing of brownfields remediation costs*.**—Taxpayers may elect, with respect to expenditures paid or incurred before January 1, 2006, to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. The Administration proposes to extend this provision permanently making it available for expenditures paid or incurred after December 31, 2005, and facilitating its use by businesses to undertake projects that may be uncertain in overall duration.

Exclude 50 percent of gains from the sale of property for conservation purposes.—The Administration proposes to create a new incentive for private, voluntary land protection. This incentive is a cost-effective, non-regulatory approach to conservation. Under the proposal, when land (or an interest in land or water) is sold for conservation purposes, only 50 percent of any gain would be included in the seller's income. This proposal applies to conservation easements and similar sales of partial interests in land, such as development rights and agricultural conservation easements, for conservation purposes. To be eligible for the exclusion, the sale may be either to a government agency or to a qualified conservation organization, and the buyer must supply a letter of intent that the acquisition will serve conservation purposes. In addition, the taxpayer or a member of the taxpayer's family must have owned the property for the three years immediately preceding the sale. Antiabuse provisions will ensure that the conservation purposes continue to be served. The provision would be effective for sales taking place after December 31, 2005 and before January 1, 2009.

Increase Energy Production and Promote Energy Conservation

Extend the tax credit for producing electricity from wind, biomass, and landfill gas and modify the tax credit for electricity produced from biomass.—Taxpayers are allowed a tax credit for electricity produced from wind, biomass, landfill gas, and certain other sources. Biomass includes closed-loop biomass (organic material from a plant grown exclusively for use at a qualifying facility to produce electricity) and open-loop biomass (biomass from agricultural livestock waste nutrients or cellulosic waste material derived from forest-related resources, agricultural sources, and other specified sources). Open-loop biomass does not include biomass that is co-fired with coal. Thus, electricity produced from biomass, other than closed-loop biomass, co-fired with coal does not qualify for the credit. The credit rate is 1.5 cents per kilowatt hour for electricity produced from wind and closed-loop biomass and 0.75 cent per kilowatt hour for electricity produced from open-loop biomass and landfill gas (both rates are adjusted for inflation since 1992). To qualify for the credit, the electricity must be produced at a facility placed in service before January 1, 2006. The Administration proposes to extend the credit for electricity produced from wind, biomass other than agricultural livestock waste nutrients, and landfill gas to electricity produced at facilities placed in service before January 1, 2008. In addition, a credit at 60 percent of the generally applicable rate for electricity produced from open-loop biomass would be allowed for electricity produced from open-loop biomass (other than agricultural livestock waste nutrients) co-fired in coal plants during the period from January 1, 2006 through December 31, 2008.

Provide tax credit for residential solar energy systems.—Current law provides a 10-percent investment tax credit to businesses for qualifying equipment that uses solar energy to generate electricity; to heat, cool or provide hot water for use in a structure; or to provide solar process heat. A credit currently is not provided for nonbusiness purchases of solar energy equipment. The Administration proposes a new tax credit for individuals who purchase solar energy equipment to generate electricity (photovoltaic equipment) or heat water (solar water heating equipment) for use in a dwelling unit that the individual uses as a residence, provided the equipment is used exclusively for purposes other than heating swimming pools. The proposed nonrefundable credit would be equal to 15 percent of the cost of the equipment and its installation; each individual taxpayer would be allowed a maximum credit of $2,000 for photovoltaic equipment and $2,000 for solar water heating equipment. The credit would apply to photovoltaic equipment placed in service after December 31, 2004 and before January 1, 2010 and to solar water heating equipment placed in service after December 31, 2004 and before January 1, 2008.

Modify treatment of nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal this limitation.

Also under current law, deductible contributions are not permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's post-1983 decommissioning costs. The Administration proposes to permit funding of all decommissioning costs through deductible contributions. Any portion of these additional contributions relating to pre-1984 costs that exceeds the amount previously deducted (other than under the nuclear decommissioning fund rules) or excluded from the taxpayer's gross income on account of the taxpayer's liability for decommissioning costs, would be allowed as a deduction ratably over the remaining useful life of the nuclear power plant.

The Administration's proposal would also permit taxpayers to make deductible contributions to a qualified fund after the end of the nuclear power plant's estimated useful life and would provide that nuclear decommissioning costs are deductible when paid. These changes in the treatment of nuclear decommissioning funds are proposed to be effective for taxable years beginning after December 31, 2004.

Provide tax credit for purchase of certain hybrid and fuel cell vehicles.—Under current law, a 10-percent tax credit up to a maximum of $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to January 1, 2006. The credit is reduced by 75 percent for purchases in 2006 and is not available for purchases after December 31, 2006. A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current, the original use of which commences with the taxpayer, and that is acquired for use by the taxpayer and not for resale. Electric vehicles and hybrid vehicles (those that have more than one source of power on board the vehicle) have the potential to reduce petroleum consumption, air pollution and greenhouse gas emissions. To encourage the purchase of such vehicles, the Administration is proposing the following tax credits: (1) A credit of up to $4,000 would be provided for the purchase of qualified hybrid vehicles after December 31, 2004 and before January 1, 2009. The amount of the credit would depend on the percentage of maximum available power provided by the rechargeable energy storage system and the amount by which the vehicle's fuel economy exceeds the 2000 model year city fuel economy. (2) A credit of up to $8,000 would be provided for the purchase of new qualified fuel cell vehicles after December 31, 2004 and before January 1, 2013. A minimum credit of $4,000 would be provided, which would increase as the vehicle's fuel efficiency exceeded the 2000 model year city fuel economy, reaching a maximum credit of $8,000 if the vehicle achieved at least 300 percent of the 2000 model year city fuel economy.

Provide tax credit for combined heat and power property.—Combined heat and power (CHP) systems are used to produce electricity (and/or mechanical power) and usable thermal energy from a single primary energy source. Depreciation allowances for CHP property vary by asset use and capacity. No income tax credit is provided under current law for investment in CHP property. CHP systems utilize thermal energy that is otherwise wasted in producing electricity by more conventional methods and achieve a greater level of overall energy efficiency, thereby lessening the consumption of primary fossil fuels, lowering total energy costs, and reducing carbon emissions. To encourage increased energy efficiency by accelerating planned investments and inducing additional investments in such systems, the Administration is proposing a 10-percent investment credit for qualified CHP systems with an electrical capacity in excess of 50 kilowatts or with a capacity to produce mechanical power in excess of 67 horsepower (or an equivalent combination of electrical and mechanical energy capacities). A qualified CHP system would be required to produce at least 20 percent of its total useful energy in the form of thermal energy and at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof) and would also be required to satisfy an energy-efficiency standard. For CHP systems with an electrical capacity in excess of 50 megawatts (or a mechanical energy capacity in excess of 67,000 horsepower), the total energy efficiency would have to exceed 70 percent. For smaller systems, the total energy efficiency would have to exceed 60 percent. Investments in qualified CHP assets that are otherwise assigned cost recovery periods of less than 15 years would be eligible for the credit, provided that the taxpayer elects to treat such property as having a 22-year class life (and thus depreciates the property using a 15-year recovery period). The credit, which would be treated as an energy credit under the investment credit component of the general business credit, and could not be used in conjunction with any other credit for the same equipment, would apply to investments in CHP property placed in service after December 31, 2004 and before January 1, 2010.

Restructure Assistance to New York City

Provide tax incentives for transportation infrastructure.—The Administration proposes to restructure the tax benefits for New York recovery that were enacted in 2002. Some of the tax benefits that were provided to New York following the attacks of September 11, 2001, likely will not be usable in the form in which they were originally provided. As such, the Administration proposed in the Mid-Session Review of the 2005 Budget to sunset certain existing New York Liberty Zone tax benefits and in their place provide tax credits to New York State and New York City for expenditures incurred in building or improving transportation infrastructure in or connecting with the New York Liberty Zone. The tax credit would be available as of the date of enactment, subject to an annual limit of $200 million ($2 billion in total over 10 years), evenly divided between the State and the City. Any unused credit limit in a given year would be added to the $200 million allowable in the following year, including years beyond the 10-year period of the credit. Similarly, expenditures that could not be credited in a given year because of the credit limit would be carried forward and used against the next year's limitation. The credit would be allowed against any payments (e.g., income tax withholding) made by the City and State under any provision of the Internal Revenue Code, other than Social Security and Medicare payroll taxes and excise taxes. The Secretary of the Treasury may prescribe such rules as are necessary to ensure that the expenditures are made for the intended purpose.

Repeal certain New York City Liberty Zone incentives.—The Administration proposes to terminate the following tax incentives provided to qualified property within the New York Liberty Zone under the 2002 economic stimulus act: (1) the additional first-year depreciation deduction; (2) the five-year recovery period for leasehold improvement property; (3) increased expensing for small businesses; and (4) the extended replacement period for the nonrecognition of gain on involuntarily converted property. These terminations are proposed to be effective on the date of enactment. Property placed in service after the date of enactment would not be eligible for the first three incentives listed above unless a binding written contract was in effect on the date of enactment, in which case the property would need to be placed in service by the original termination dates provided in the 2002 economic stimulus act. Other related changes to the Internal Revenue Code would be made as appropriate.

SIMPLIFY THE TAX LAWS FOR FAMILIES

Simplify adoption tax benefits.—Under current law, for taxable years beginning before January 1, 2011, the following tax benefits are provided to taxpayers who adopt children: (1) a nonrefundable tax credit for qualified expenses incurred in the adoption of a child, up to a certain limit; and (2) the exclusion from gross income of qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program, up to a certain limit.

Taxpayers may not claim the credit for expenses that are excluded from gross income. In 2005, the limitation on qualified adoption expenses for both the credit and the exclusion is $10,630. Taxpayers who adopt children with special needs may claim the full $10,630 credit or exclusion even if adoption expenses are less than this amount. Taxpayers may carry forward unused credit amounts for up to five years. When modified adjusted gross income exceeds $159,450 (in 2005), both the credit amount and the amount excluded from gross income are reduced pro-rata over the next $40,000 of modified adjusted gross income. The maximum credit and exclusion and the income at which the phase-out range begins are indexed annually for inflation. For taxable years beginning after December 31, 2010, taxpayers will be able to claim the credit only for actual expenses for the adoption of children with special needs. For these taxpayers the qualified expense limit will be $6,000, the credit will be reduced pro-rata between $75,000 and $115,000 of modified adjusted gross income, and the credit amount and phase-out range will not be indexed annually for inflation. Taxpayers may not exclude employer-provided adoption assistance from gross income for taxable years beginning after December 31, 2010.

To reduce marginal tax rates and simplify computations of tax liabilities, the Administration is proposing to eliminate the income-related phaseout of the adoption tax credit and exclusion. The proposal would be effective for taxable years beginning after December 31, 2005. The phaseout of adoption tax benefits increases complexity for all taxpayers using the adoption tax provisions, including the vast majority who are not affected by the phaseouts; raises marginal tax rates for taxpayers in the phase-out range; and with the higher phase-out income levels under the 2001 tax cut, affects fewer than 10,000 taxpayers. The broader eligibility criteria, larger qualifying expense limitations, and the employer exclusion would apply in taxable years beginning after December 31, 2010 as a result of the Administration's proposal to extend the 2001 tax cut provisions permanently.

Clarify eligibility of siblings and other family members for child-related tax benefits.—The 2004 tax relief bill created a uniform definition of a child, allowing, in many circumstances, a taxpayer to claim the same child for five different child-related tax benefits. Under the new rules, a qualifying child must meet relationship, residency, and age tests. While the new rules simplify the determination of eligibility for many child-related tax benefits, the elimination of certain complicated factual tests to determine if siblings and certain other family members were eligible to claim a qualifying child may have some unintended consequences. The new rules effectively deny the EITC to some young taxpayers who are the sole guardians of their younger siblings. Yet some taxpayers will be able to avoid income limitations on child-related tax benefits by allowing other family members, who have lower incomes, to claim the taxpayers' sons or daughters as qualifying children. To ensure that deserving taxpayers receive child-related tax benefits, the Administration proposes to clarify the eligibility of siblings and other family members for these benefits. First, a taxpayer would not be a qualifying child of another individual if the taxpayer is older than that individual. However, an individual could be a qualifying child of a younger sibling if the individual is permanently and totally disabled. Second, if a parent resides with his or her child for over half the year, the parent would be the only individual eligible to claim the child as a qualifying child. The parent could waive the child-related tax benefits to another member of the household who has higher adjusted gross income and is otherwise eligible for the tax benefits. The proposal is effective for taxable years beginning after December 31, 2004.

STRENGTHEN THE EMPLOYER-BASED PENSION SYSTEM

Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans.—Qualified retirement plans consist of defined benefit plans and defined contribution plans. In recent years, many plan sponsors have adopted cash balance and other "hybrid" plans that combine features of defined benefit and defined contribution plans. A cash balance plan is a defined benefit plan that provides for annual "pay credits" to a participant's "hypothetical account" and "interest credits" on the balance in the hypothetical account. Questions have been raised about whether such plans satisfy the rules relating to age discrimination and the calculation of lump sum distributions. The Administration proposes to (1) ensure fairness for older workers in cash balance conversions, (2) protect the defined benefit system by clarifying the status of cash balance plans, and (3) remove the effective ceiling on interest credits in cash balance plans. All changes would be effective prospectively.

Strengthen funding for single-employer pension plans.—Under current law, defined benefit pension plans are subject to minimum funding requirements imposed under both the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (ERISA). In the case of a qualified plan, the Internal Revenue Code excludes such contributions from gross income and allows a deduction for the contributions, subject to certain limits on the maximum deductible amount. The calculation of the minimum funding requirements and the limits on deductible contributions are determined under a series of complex rules and measures of assets and liability, many of which are manipulable and none of which entail the use of an accurate measure of the plan's assets and its true liabilities.

The Administration proposes rationalizing the multiple sets of funding rules applicable to single-employer defined benefit plans and replacing them with a single set of rules that provide for: (1) funding targets that are based on meaningful, accurate measures of liabilities that reflect the financial health of the employer; (2) the use of market value of assets; (3) a seven-year amortization period for funding shortfalls; (4) the opportunity for an employer to make additional deductible contributions in good years, even when the plan's assets are above the funding target; and (5) meaningful consequences for employers and plans whose funded status does not improve.

These funding rules changes and the addition of meaningful consequences for employers and plans whose funded status does not improve and improved disclosure to plan participants, investors and regulators are part of an overall package of reforms that will improve the health of defined benefit pensions and the PBGC guarantee system. As described in Chapter 7 of Analytical Perspectives and the Department of Labor Chapter of the Budget volume, this overall package includes reform of the premium structure for the PBGC, revision in the application of the PBGC guarantee rates and changes to the bankruptcy law.

Reflect market interest rates in lump sum payments.—Current law generally requires that a lump sum paid from a pension plan be calculated using the rate of interest on 30-year Treasury securities for the month preceding the distribution. Because there are no 30-year Treasury securities outstanding, the interest rate on the Treasury bond due February 15, 2031 is used for this purpose. The Administration proposes to require that these calculations reflect market interest rates and lump sum calculations would be calculated using interest rates that are drawn from a zero-coupon corporate bond yield curve. The yield curve would be issued monthly by the Secretary of Treasury and would be based on the interest rates (averaged over 90 business days) for high quality corporate bonds with varying maturities. In order to avoid disruptions, the proposal would be phased in for plan years beginning in 2007 and 2008 and would not be fully effective until the plan year beginning in 2009.

CLOSE LOOPHOLES AND IMPROVE TAX COMPLIANCE

Combat abusive foreign tax credit transactions.—Current law allows taxpayers a credit against U.S. taxes for foreign taxes incurred with respect to foreign income, subject to specified limits. The Administration proposes to provide the Department of Treasury with additional regulatory authority to ensure that the foreign tax credit rules cannot be used to achieve inappropriate results that are not consistent with the underlying economics of the transactions in which the foreign tax credits arise. The regulatory authority would allow the Department of Treasury to prevent the inappropriate separation of foreign taxes from the related foreign income in cases where taxes are imposed on any person in respect of income of an entity. Regulations could provide for the disallowance of a credit for all or a portion of the foreign taxes or the reallocation of the foreign taxes among the participants to the transaction.

Modify the active trade or business test.—Current law allows corporations to avoid recognizing gain in certain spin-off and split-off transactions provided that, among other things, the active trade or business test is satisfied. The active trade or business test requires that immediately after the distribution, the distributing corporation and the corporation the stock of which is distributed (the controlled corporation) be engaged in a trade or business that has been actively conducted throughout the five-year period ending on the date of the distribution. There is no statutory requirement that a certain percentage of the distributing corporation's or controlled corporation's assets be used in that active trade or business in order for the active trade or business test to be satisfied. Because certain non-pro rata distributions resemble redemptions for cash, the Administration proposes to require that in the case of a non-pro rata distribution, in order for a corporation to satisfy the active trade or business test, as of the date of the distribution, at least 50 percent of its assets, by value, must be used or held for use in a trade or business that satisfies the active trade or business test.

Impose penalties on charities that fail to enforce conservation easements.—Although gifts of partial interests in property generally are not deductible as charitable contributions, current law allows a deduction for certain restrictions granted in perpetuity on the use that may be made of real property (such as an easement). A deduction is allowed only if the contribution is made to a qualified organization exclusively for conservation purposes. To qualify to receive such qualified conservation contributions, a charity must have a commitment to protect the conservation purposes of the donation and have the resources to enforce the restrictions. The Department of Treasury is concerned that in some cases charities are failing to monitor and enforce the conservation restrictions for which charitable contribution deductions were claimed. The proposal would impose significant penalties on any charity that removes or fails to enforce such a conservation restriction, or transfers the easement without ensuring that the conservation purposes will be protected in perpetuity. The amount of the penalty would be determined based on the value of the easement shown on the appraisal summary provided to the charity by the donor. The Secretary of the Treasury would be authorized to waive the penalty in certain circumstances. The Secretary of the Treasury also would be authorized to require such additional reporting as may be necessary or appropriate to ensure that the conservation purposes are protected in perpetuity.

Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields.—In general, an organization that is otherwise exempt from Federal income tax is taxed on income from any trade or business regularly carried on by the organization that is not substantially related to the organization's exempt purposes. In addition, income derived from property that is debt-financed generally is subject to unrelated business income tax. The 2004 jobs creation act created a special exclusion from unrelated business taxable income of gain or loss from the sale or exchange of certain qualifying brownfield properties. The exclusion applies regardless of whether the property is debt-financed. The new provision adds considerable complexity to the Internal Revenue Code and, because there is no limit on the amount of tax-free gain, could exempt from tax real estate development considerably beyond mere environmental remediation. The proposal would eliminate this special exclusion retroactive to January 1, 2005.

Apply an excise tax to amounts received under certain life insurance contracts.—Under current law, both death benefits and accrual of cash value under a life insurance contract are treated favorably for Federal income tax purposes. In many states, a charity has an insurable interest in the life of a consenting donor. The Department of Treasury has learned of arrangements in which private investors join with a charity to purchase life insurance on the lives of the charity's donors. The private investors have no relationship to the insured individuals, however, except by reason of the arrangement. These arrangements do more to facilitate investment by private investors in life insurance contracts than to further a charity's exempt purposes and may inappropriately afford benefits to private investors that would not otherwise be available without the charity's involvement. The Administration proposes to apply a nondeductible 25 percent excise tax to death benefits, dividends, withdrawals, loans or surrenders under a life insurance contract if: (1) a charity has ever had a direct or indirect ownership interest in the contract; and (2) a person other than a charity has ever had a direct or indirect interest in the same contract (including an interest in an entity holding an interest in that contract). The excise tax would not apply in enumerated situations that present a low risk of abuse. The proposal would be effective with respect to amounts received under life insurance contracts entered into after February 7, 2005.

Limit related party interest deductions.—Current law (section 163(j) of the Internal Revenue Code) denies U.S. tax deductions for certain interest expenses paid to a related party where (1) the corporation's debt-to-equity ratio exceeds 1.5 to 1, and (2) net interest expenses exceed 50 percent of the corporation's adjusted taxable income (computed by adding back net interest expense, depreciation, amortization, depletion, and any net operating loss deduction). If these thresholds are exceeded, no deduction is allowed for interest in excess of the 50-percent limit that is paid to a related party or paid to an unrelated party but guaranteed by a related party, and that is not subject to U.S. tax. Any interest that is disallowed in a given year is carried forward indefinitely and may be deductible in a subsequent taxable year. A three-year carryforward for any excess limitation (the amount by which interest expense for a given year falls short of the 50-percent limit) is also allowed. Because of the opportunities available under current law to reduce inappropriately U.S. tax on income earned on U.S. operations through the use of foreign related-party debt, the Administration proposes to tighten the interest disallowance rules of section 163(j) as follows: (1) The current law 1.5 to 1 debt-to-equity safe harbor would be eliminated; (2) the adjusted taxable income threshold for the limitation would be reduced from 50 percent to 25 percent of adjusted taxable income with respect to disqualified interest other than interest paid to unrelated parties on debt that is subject to a related-party guarantee, which generally would remain subject to the current law 50 percent threshold; and (3) the indefinite carryforward for disallowed interest would be limited to ten years and the three-year carryforward of excess limitation would be eliminated. The Department of Treasury also is conducting a study of these rules and the potential for further modifications to ensure the prevention of inappropriate income-reduction opportunities.

Clarify and simplify qualified tuition programs.—Current law provides special tax treatment for contributions to and distributions from qualified tuition programs under Section 529. The purpose of these programs is to encourage saving for the higher education expenses of designated beneficiaries. However, current law is unclear in certain situations with regard to the transfer tax consequences of changing the designated beneficiary of a qualified tuition program account. In addition, current law creates opportunities for inappropriate use of these accounts. The proposal would simplify the tax consequences under these programs and promote use of these accounts to save for higher education. The most significant change made by this proposal is the elimination of substantially all post-contribution transfer taxes, thus permitting tax-free changes of the designated beneficiary of an account, without limitation as to the relationship or number of generations between the current and former beneficiaries. Any distribution used to pay the beneficiary's qualified higher education expenses would continue to be tax-free. However, to eliminate the potential transfer tax benefit of using an account for purposes not intended by the statute, the principal portion of any distribution that is not used for higher education expenses generally would be subject to a new excise tax (payable from the account) once the cumulative amount of these distributions exceeds a stated amount per beneficiary. Distributions from an account would be permitted to be made only to or for the benefit of the designated beneficiary. However, a contributor who sets up an account would be permitted to withdraw funds from the account during the contributor's life, subject to income tax on the income portion of the withdrawal. The income portion of a withdrawal by the account's contributor generally also would be subject to an additional tax to discourage individuals from using these accounts to save for retirement. The proposal would be effective for Section 529 accounts established after the date of enactment, and no additional contributions would be permitted to preexisting Section 529 savings accounts unless those accounts elect to be governed by the new rules.

TAX ADMINISTRATION, UNEMPLOYMENT INSURANCE, AND OTHER

Improve Tax Administration

Implement IRS administrative reforms.—The proposed modification to the IRS Restructuring and Reform Act of 1998 is comprised of five parts. The first part modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations. The second part adopts measures to curb frivolous submissions and filings that are intended to impede or delay tax administration. The third part allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The fourth part streamlines jurisdiction over collection due process cases in the Tax Court, thereby simplifying procedures and reducing the cycle time for certain collection due process cases. The fifth part eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Secretary of the Treasury establish standards to determine when an opinion is appropriate.

Initiate IRS cost saving measures.—The Administration has two proposals to improve IRS efficiency and performance from current resources. The first proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to retain a portion of the amount collected before transmitting the balance to the IRS, thereby reducing government transaction costs. The offset amount would be included as part of the 15-percent limit on levies against income and would also be credited against the taxpayer's liability. The second proposal would encourage increased electronic filing of income tax returns by extending the April filing date for electronically filed income tax returns to April 30th, provided that any tax due is also paid electronically. The proposal also would provide the IRS additional authority to require electronic filing. This proposal would allow the IRS to process more returns and payments efficiently.

Allow IRS to access information in the National Directory of New Hires for tax administration purposes.—The National Directory of New Hires (NDNH), an electronic database maintained by the Department of Health and Human Services, contains timely, uniformly compiled employment data from State agencies across the country. Currently, the IRS may obtain data from the NDNH, but only for limited purposes. Access to NDNH data for tax administration purposes generally would make the IRS more productive by reducing the amount of resources it must dedicate to obtaining and processing data. The Administration proposes to amend the Social Security Act to allow the IRS access to NDNH data for general tax administration purposes, including data matching, verification of taxpayer claims during return processing, preparation of substitute returns for non-compliant taxpayers, and identification of levy sources. Data obtained by the IRS from the NDNH would be protected by existing taxpayer privacy law, including civil and criminal sanctions. The proposal would be effective on the date of enactment.

Extend IRS authority to fund undercover operations.—Current law places the IRS on equal footing with other Federal Law enforcement agencies by permitting the IRS to fund certain necessary and reasonable expenses of undercover operations. These undercover operations include international and domestic money laundering and narcotics operations. The Administration proposes to extend this funding authority, which will expire on December 31, 2005, through December 31, 2010.

Strengthen Financial Integrity of Unemployment Insurance

Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance.—The Administration has a five-part proposal to strengthen the financial integrity of the unemployment insurance (UI) system. The Administration's proposal will boost States' incentives to recover benefit overpayments by permitting them to use a portion of recovered funds on fraud and error reduction. The proposal would also require States to impose a monetary penalty on UI fraud, which would be used to reduce overpayments; permit more active participation by private collection agencies in the recovery of overpayments and delinquent employer taxes; require States to charge employers when their actions lead to overpayments; and collect delinquent UI overpayments through garnishment of Federal tax refunds. These efforts to strengthen the financial integrity of the UI system will keep State UI taxes down and improve the solvency of the State trust funds.

Other Proposals

Modify pesticide registration fee.—The Environmental Protection Agency has the authority and has promulgated a rule to collect fees for the registration of new pesticides. The collection of this fee has been blocked through appropriations acts since 1989. Most recently, provisions in the 2004 Consolidated Appropriations Act suspended this authority through 2010. The Administration proposes to eliminate the prohibition on the collection of the fee beginning in 2006 and to reclassify the fee as offsetting receipts.

Increase Indian gaming activity fees.—The National Indian Gaming Commission regulates and monitors gaming operations conducted on Indian lands. Since 1998, the Commission has been prohibited from collecting more than $8 million in annual fees from gaming operations to cover the costs of its oversight responsibilities. The Administration proposes to amend the current fee structure so that the Commission can adjust its activities to the growth in the Indian gaming industry.

REAUTHORIZE FUNDING FOR THE HIGHWAY TRUST FUND

Extend excise taxes deposited in the Highway Trust Fund.—Excise taxes imposed on nonaviation gasoline, diesel fuel, kerosene, special motor fuels, heavy highway vehicles, and tires for heavy highway vehicles are generally deposited in the Highway Trust Fund. Tax is imposed on nonaviation gasoline at a rate of 18.4 cents per gallon, on diesel fuel and kerosene at a rate of 24.4 cents per gallon, and on special motor fuels at varying rates. The tax rates are scheduled to fall, generally by 0.1 cent per gallon, on April 1, 2005 (reflecting the scheduled expiration of the LUST Trust Fund tax) and to 4.3 cents per gallon (or comparable rates in the case of special motor fuels) on October 1, 2005. A tax equal to 12 percent of the sales price is imposed on the first retail sale of heavy highway vehicles (generally, trucks with a gross weight greater than 33,000 pounds, trailers with a gross weight greater than 26,000 pounds, and highway tractors). In addition, a highway use tax of up to $550 per year is imposed on highway vehicles with a gross weight of at least 55,000 pounds. A tax is also imposed on tires with a rated load capacity exceeding 3,500 pounds, generally at a rate of 0.945 cent per pound of excess. The taxes on heavy highway vehicles and tires for heavy highway vehicles are scheduled to expire on September 30, 2005. The Administration proposes to extend the taxes on nonaviation gasoline, diesel fuel and kerosene, and special motor fuels at their current rates, except to the extent attributable to the LUST Trust Fund tax, through September 30, 2011. The Administration also proposes to extend the taxes on heavy highway vehicles and tires for heavy highway vehicles at their current rates through September 30, 2011.

Allow tax-exempt financing for private highway projects and rail-truck transfer facilities.—Interest on bonds issued by State and local governments to finance activities carried out and paid for by private persons (private activity bonds) is taxable unless the activities are specified in the Internal Revenue Code. The volume of certain tax-exempt private activity bonds that State and local governments may issue in each calendar year is limited by state-wide volume limits. The Administration proposes to provide authority to issue an aggregate of $15 billion of tax-exempt private activity bonds beginning in 2005 for the development of highway facilities and surface freight transfer facilities. Highway facilities eligible for financing would consist of any surface transportation project eligible for Federal assistance under Title 13 of the United States Code, or any project for an international bridge or tunnel for which an international entity authorized under Federal or State law is responsible. Surface freight transfer facilities would consist of facilities for the transfer of freight from truck to rail or rail to truck, including any temporary storage facilities directly related to those transfers. The Secretary of Transportation would allocate the $15 billion, which would not be subject to the aggregate annual state private activity bond volume limit, among competing projects.

PROMOTE TRADE

Implement free trade agreements with Bahrain, Panama, and the Dominican Republic.—Free trade agreements are expected to be completed with Bahrain, Panama, and the Dominican Republic in 2005, with ten-year implementation to begin in fiscal year 2006. These agreements will continue the Administration's effort to use free trade agreements to benefit U.S. consumers and producers as well as strengthen the economies of our partner countries.

EXTEND EXPIRING PROVISIONS

Extend permanently the research and experimentation (R&E) tax credit.—The Administration proposes to extend permanently the 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit, which are scheduled to expire on December 31, 2005.

Extend and modify the work opportunity tax credit and the welfare-to-work tax credit.—Under present law, the work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit is available for a qualified individual who begins work before January 1, 2006.

Under present law, the welfare-to-work tax credit provides an incentive for hiring certain recipients of long-term family assistance. The credit is 35 percent of up to $10,000 of eligible wages in the first year of employment and 50 percent of wages up to $10,000 in the second year of employment. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. This credit is available for qualified individuals who begin work before January 1, 2006.

The Administration proposes to simplify employment incentives by combining the credits into one credit and making the rules for computing the combined credit simpler. The credits would be combined by creating a new welfare-to-work targeted group under the work opportunity tax credit. The minimum employment periods and credit rates for the first year of employment under the present work opportunity tax credit would apply to welfare-to-work employees. The maximum amount of eligible wages would continue to be $10,000 for welfare-to-work employees and $6,000 for other targeted groups. In addition, the second year 50-percent credit currently available under the welfare-to-work credit would continue to be available for welfare-to-work employees under the modified work opportunity tax credit. Qualified wages would be limited to cash wages. The work opportunity tax credit would also be simplified by eliminating the need to determine family income for qualifying ex-felons (one of the present targeted groups). The modified work opportunity tax credit would apply to individuals who begin work after December 31, 2005 and before January 1, 2007.

Extend the first-time homebuyer credit for the District of Columbia.—A one-time nonrefundable $5,000 credit is available to purchasers of a principal residence in the District of Columbia who have not owned a residence in the District during the year preceding the purchase. The credit phases out for taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). The credit does not apply to purchases after December 31, 2005. The Administration proposes to extend the credit for one year, making the credit available with respect to purchases after December 31, 2005 and before January 1, 2007.

Extend authority to issue Qualified Zone Academy Bonds.—Current law allows State and local governments to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds have to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2005. In addition, unused authority arising in 1998 and 1999 can be carried forward for up to three years and unused authority arising in 2000 through 2005 can be carried forward for up to two years. The Administration proposes to authorize the issuance of an additional $400 million of qualified zone academy bonds in calendar years 2006; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

Extend deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided augmented deductions, not subject to this limitation, for certain contributions. Under current law, an augmented deduction is provided for contributions of computer technology and equipment to public libraries and to U.S. schools for educational purposes in grades K-12. The Administration proposes to extend the deduction, which expires with respect to donations made after December 31, 2005, to apply to donations made before January 1, 2007.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—Current law permits disclosure of tax return information relating to terrorism in two situations. The first is when an executive of a Federal law enforcement or intelligence agency has reason to believe that the return information is relevant to a terrorist incident, threat or activity and submits a written request. The second is when the IRS wishes to apprise a Federal law enforcement agency of a terrorist incident, threat or activity. The Administration proposes to extend this disclosure authority, which will expire on December 31, 2005, through December 31, 2006.

Extend excise taxes deposited in the Leaking Underground Storage Tank (LUST) Trust Fund.—An excise tax is imposed, generally at a rate of 0.1 cents per gallon, on gasoline and other liquid motor fuels used on highways, in aviation, on inland waterways, and in diesel-powered trains. The tax is deposited in the LUST Trust Fund. The tax is scheduled to expire on March 31, 2005. The Administration proposes to extend the tax at the current rate through March 31, 2007.

Extend abandoned mine reclamation fees.—Collections from abandoned mine reclamation fees are allocated to States and Tribes for reclamation grants. Current fees of 35 cents per ton for surface mined coal, 15 cents per ton for underground mined coal, and 10 cents per ton for lignite coal are scheduled to expire on June 30, 2005. Abandoned mine land problems are expected to exist in certain States after all the money from the collection of fees under current law is expended. The Administration proposes to extend these fees. The Administration also proposes to modify the authorization language to allocate more of the receipts collected toward restoration of abandoned coal mine land.

Extend excise tax on coal at current rates.—Excise taxes levied on coal mined and sold for use in the United States are deposited in the Black Lung Disability Trust Fund. Amounts deposited in the Fund are used to cover the cost of program administration and compensation, medical, and survivor benefits to eligible miners and their survivors, when mine employment terminated prior to 1970 or when no mine operator can be assigned liability. Current tax rates on coal sold by a producer are $1.10 per ton of coal from underground mines and $0.55 per ton of coal from surface mines; however, these rates may not exceed 4.4 percent of the price at which the coal is sold. Effective for coal sold after December 31, 2013, the tax rates on coal from underground mines and surface mines will decline to $0.50 per ton and $0.25 per ton, respectively, and will be capped at 2 percent of the price at which the coal is sold. The Administration proposes to repeal the reduction in these tax rates effective for sales after December 31, 2013, and keep current rates in effect until the Black Lung Disability Trust Fund debt is repaid.

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS

(in millions of dollars)

	2005	2006	2007	2008	2009	2010	2006–10	2006–15
Make Permanent Certain Tax Cuts Enacted in 2001 and 2003 (assumed in the baseline):								
Dividends tax rate structure	309	509	547	537	–16,725	–568	–15,700	–102,905
Capital gains tax rate structure	....	....	....	–5,268	–7,473	–5,076	–17,817	–59,016
Expensing for small business	....	....	....	–3,402	–5,417	–4,073	–12,892	–21,897
Marginal individual income tax rate reductions	....	....	....	....	....	....	....	–502,228
Child tax credit [1]	....	....	....	....	....	....	....	–96,777
Marriage penalty relief [2]	....	....	....	....	....	....	....	–36,029
Education incentives	....	....	....	....	....	3	3	–8,687
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	4	–557	–910	–1,514	–1,847	–2,192	–7,020	–256,057
Modifications of pension plans	....	....	....	....	....	....	....	–2,323
Other incentives for families and children	....	....	....	....	....	5	5	–3,594
Total make permanent certain tax cuts enacted in 2001 and 2003	313	–48	–363	–9,647	–31,462	–11,901	–53,421	–1,089,513
Tax Incentives:								
Simplify and encourage saving:								
Expand tax-free savings opportunities	....	3,709	7,151	4,069	1,693	199	16,821	1,461
Consolidate employer-based savings accounts	....	–224	–335	–357	–382	–411	–1,709	–14,816
Establish Individual Development Accounts (IDAs)	....	....	–134	–286	–326	–300	–1,046	–1,763
Total simplify and encourage saving	....	3,485	6,682	3,426	985	–512	14,066	–15,118
Invest in health care:								
Provide a refundable tax credit for the purchase of health insurance [3]	....	–19	–1,435	–1,543	–1,370	–1,241	–5,608	–9,897
Provide an above-the-line deduction for high-deductible insurance premiums	....	–200	–2,029	–2,316	–2,636	–2,876	–10,057	–28,495
Provide a refundable tax credit for contributions of small employers to employee HSAs [4]	....	–61	–304	–834	–1,545	–2,025	–4,769	–17,760
Improve the Health Coverage Tax Credit [5]	....	....	–3	–4	–5	–5	–17	–49
Allow the orphan drug tax credit for certain pre-designation expenses	....	....	....	....	....	....	–1	–3
Total invest in health care	....	–280	–3,771	–4,697	–5,556	–6,147	–20,452	–56,204
Provide incentives for charitable giving:								
Permit tax-free withdrawals from IRAs for charitable contributions	–70	–335	–318	–318	–313	–304	–1,588	–3,095
Expand and increase the enhanced charitable deduction for contributions of food inventory	–42	–87	–96	–106	–116	–127	–532	–1,388
Reform excise tax based on investment income of private foundations	....	–148	–98	–105	–111	–119	–581	–1,321
Modify tax on unrelated business taxable income of charitable remainder trusts	–6	–5	–6	–6	–6	–7	–30	–69

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2005	2006	2007	2008	2009	2010	2006–10	2006–15
Modify basis adjustment to stock of S corporations contributing appreciated property	–4	–20	–21	–25	–28	–32	–126	–354
Repeal the $150 million limitation on qualified 501(c)(3) bonds	–3	–6	–10	–11	–10	–10	–47	–92
Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property	....	–2	–5	–9	–16	–24	–56	–278
Total provide incentives for charitable giving	–125	–603	–554	–580	–600	–623	–2,960	–6,597
Strengthen education:								
Extend, increase, and expand the above-the-line deduction for qualified out-of-pocket classroom expenses	....	–27	–267	–279	–282	–285	–1,140	–2,630
Encourage telecommuting:								
Exclude from income the value of employer-provided computers, software, and peripherals	....	–29	–50	–50	–55	–65	–249	–767
Provide assistance to distressed areas:								
Establish Opportunity Zones	....	–433	–806	–853	–899	–912	–3,903	–9,594
Provide disaster relief:								
Provide tax relief for FEMA hazard mitigation assistance programs	–20	–40	–40	–40	–40	–40	–200	–400
Increase housing opportunities:								
Provide tax credit for developers of affordable single-family housing	....	–7	–84	–342	–815	–1,425	–2,673	–17,370
Protect the environment:								
Extend permanently expensing of brownfields remediation costs	....	–138	–215	–203	–195	–184	–935	–1,743
Exclude 50 percent of gains from the sale of property for conservation purposes	....	–47	–92	–105	–60	....	–304	–304
Total protect the environment	....	–185	–307	–308	–255	–184	–1,239	–2,047
Increase energy production and promote energy conservation:								
Extend the tax credit for producing electricity from wind, biomass, and landfill gas and modify the tax credit for electricity from biomass	–48	–144	–321	–260	–160	–163	–1,048	–1,779
Provide tax credit for residential solar energy systems	–5	–11	–19	–24	–34	–16	–104	–104
Modify treatment of nuclear decommissioning funds	–47	–166	–162	–170	–177	–183	–858	–1,881
Provide tax credit for purchase of certain hybrid and fuel cell vehicles [6]	–13	–260	–447	–614	–680	–23	–2,024	–2,532
Provide tax credit for combined heat and power property	–17	–109	–84	–105	–114	–36	–448	–394
Total increase energy production and promote energy conservation	–130	–690	–1,033	–1,173	–1,165	–421	–4,482	–6,690
Restructure assistance to New York City:								
Provide tax incentives for transportation infrastructure	....	–200	–200	–200	–200	–200	–1,000	–2,000
Repeal certain New York City Liberty Zone incentives	....	200	200	200	200	200	1,000	2,000
Total restructure assistance to New York City	....	....	....	....	....	....	....	....
Total tax incentives	–275	1,191	–230	–4,896	–8,682	–10,614	–23,232	–117,417
Simplify the Tax Laws for Families:								
Simplify adoption tax benefits	....	–4	–40	–42	–43	–45	–174	–426
Clarify eligibility of siblings and other family members for child related tax benefits [7]	11	51	78	77	60	40	306	536
Total simplify the tax laws for families	11	47	38	35	17	–5	132	110
Strengthen the Employer-Based Pension System:								
Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans	....	57	62	78	92	104	393	1,096
Strengthen funding for single-employer pension plans	....	151	1,432	–869	–2,699	–1,762	–3,747	–12,735
Reflect market interest rates in lump sum payments	....	....	–3	–8	–15	–20	–46	–241
Total strengthen the employer-based pension system	....	208	1,491	–799	–2,622	–1,678	–3,400	–11,880
Close Loopholes and Improve Tax Compliance:								
Combat abusive foreign tax credit transactions	1	2	2	2	2	3	11	26
Modify the active trade or business test	2	6	8	8	8	8	38	87
Impose penalties on charities that fail to enforce conservation easements	3	8	8	8	9	9	42	96

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2005	2006	2007	2008	2009	2010	2006–10	2006–15
Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields	1	4	12	23	37	49	125	242
Apply an excise tax to amounts received under certain life insurance contracts	2	7	12	17	23	28	87	323
Limit related party interest deductions	74	128	134	141	148	155	706	1,607
Clarify and simplify qualified tuition programs	....	4	12	13	14	20	63	222
Total close loopholes and improve tax compliance	83	159	188	212	241	272	1,072	2,603
Tax Administration, Unemployment Insurance, and Other:								
Improve tax administration:								
Implement IRS administrative reforms and initiate cost saving measures [8]	....	....	....	....	....	....	....	....
Strengthen financial integrity of unemployment insurance:								
Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance [6]	....	....	6	–6	–129	–530	–659	–2,856
Other proposals:								
Modify pesticide registration fee	....	....	....	....	....	....	....	–152
Increase Indian gaming activity fees	....	....	4	4	5	5	18	43
Total tax administration, unemployment insurance, and other	....	....	10	–2	–124	–525	–641	–2,965
Reauthorize Funding for the Highway Trust Fund:								
Extend excise taxes deposited in the Highway Trust Fund [6]	....	10	11	11	11	11	54	65
Allow tax-exempt financing for private highway projects and rail-truck transfer facilities	–5	–22	–47	–75	–92	–97	–333	–601
Total reauthorize funding for the Highway Trust Fund	–5	–12	–36	–64	–81	–86	–279	–536
Promote Trade:								
Implement free trade agreements with Bahrain, Panama and the Dominican Republic [6]	....	–56	–84	–91	–97	–102	–430	–976
Extend Expiring Provisions:								
Research & Experimentation (R&E) tax credit	....	–2,097	–4,601	–5,944	–6,889	–7,669	–27,200	–76,225
Combined work opportunity/welfare-to-work tax credit	....	–131	–166	–65	–16	–5	–383	–383
First-time homebuyer credit for DC	....	–1	–18	....	....	....	–19	–19
Authority to issue Qualified Zone Academy Bonds	....	–3	–8	–13	–18	–20	–62	–162
Deduction for corporate donations of computer technology	....	–73	–49	....	....	....	–122	–122
Disclosure of tax return information related to terrorist activity [8]	....	....	....	....	....	....	....	....
LUST Trust Fund taxes [6]	74	152	77	....	....	....	229	229
Abandoned mine reclamation fees	....	304	312	318	322	323	1,579	3,230
Excise tax on coal [6]	....	....	....	....	....	....	....	479
Total extend expiring provisions	74	–1,849	–4,453	–5,704	–6,601	–7,371	–25,978	–72,973
Total budget proposals, including proposals assumed in the baseline	201	–360	–3,439	–20,956	–49,411	–32,010	–106,177	–1,293,547
Total budget proposals, excluding proposals assumed in the baseline	–112	–312	–3,076	–11,309	–17,949	–20,109	–52,756	–204,034

[1] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $37,319 million for 2006–2015.

[2] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $7,491 million for 2006–2015.

[3] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $78 million for 2006, $3,660 million for 2007, $5,514 million for 2008, $6,529 million for 2009, $7,035 million for 2010, $22,816 million for 2006–2010 and $64,078 million for 2006–2015.

[4] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $18 million for 2006, $87 million for 2007, $237 million for 2008, $392 million for 2009, $589 million for 2010, $1,323 million for 2006–2010 and $4,930 million for 2006–2015.

[5] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $3 million for 2006, $10 million for 2007, $11 million for 2008, $13 million for 2009, $14 million for 2010, $51 million for 2006–2010 and $130 million for 2006–2015.

[6] Net of income offsets.

[7] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is -$115 million for 2006, -$150 million for 2007, -$168 million for 2008, -$196 million for 2009, -$258 million for 2010, -$887 million for 2006–2010 and -$2,239 million for 2006–2015.

[8] No net budgetary impact.

Table 17–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2004 Actual	Estimate 2005	2006	2007	2008	2009	2010
Individual income taxes (federal funds):							
Existing law	808,959	893,698	964,283	1,069,364	1,177,249	1,280,242	1,370,919
Proposed Legislation	....	6	2,594	1,805	–10,076	–35,103	–17,644
Total individual income taxes	**808,959**	**893,704**	**966,877**	**1,071,169**	**1,167,173**	**1,245,139**	**1,353,275**
Corporation income taxes:							
Federal funds:							
Existing law	189,370	226,431	222,811	234,112	252,724	264,958	270,000
Proposed Legislation	....	95	–2,553	–4,295	–9,307	–12,595	–12,367
Total Federal funds corporation income taxes	189,370	226,526	220,258	229,817	243,417	252,363	257,633
Trust funds:							
Hazardous substance superfund	1	....	....	....	....	....	....
Total corporation income taxes	**189,371**	**226,526**	**220,258**	**229,817**	**243,417**	**252,363**	**257,633**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	457,120	479,891	507,087	537,849	568,092	598,946	635,310
Disability insurance (Off-budget)	77,625	81,472	86,104	91,333	96,469	101,708	107,883
Hospital insurance	150,589	161,360	172,135	182,412	193,079	204,007	216,710
Railroad retirement:							
Social Security equivalent account	1,729	1,726	1,760	1,778	1,819	1,853	1,891
Rail pension and supplemental annuity	2,297	2,187	2,209	2,252	2,192	2,203	2,364
Total employment and general retirement	689,360	726,636	769,295	815,624	861,651	908,717	964,158
On-budget	154,615	165,273	176,104	186,442	197,090	208,063	220,965
Off-budget	534,745	561,363	593,191	629,182	664,561	700,654	743,193
Unemployment insurance:							
Deposits by States [1]	32,605	35,371	37,513	38,870	39,620	40,399	42,420
Proposed Legislation	....	....	....	7	–7	–162	–662
Federal unemployment receipts [1]	6,718	7,009	7,357	7,181	6,011	5,798	6,124
Railroad unemployment receipts [1]	130	96	86	101	124	132	121
Total unemployment insurance	39,453	42,476	44,956	46,159	45,748	46,167	48,003
Other retirement:							
Federal employees' retirement—employee share	4,543	4,574	4,540	4,400	4,301	4,153	4,038
Non-Federal employees retirement [2]	51	45	43	39	36	33	30
Total other retirement	4,594	4,619	4,583	4,439	4,337	4,186	4,068
Total social insurance and retirement receipts	**733,407**	**773,731**	**818,834**	**866,222**	**911,736**	**959,070**	**1,016,229**
On-budget	198,662	212,368	225,643	237,040	247,175	258,416	273,036
Off-budget	534,745	561,363	593,191	629,182	664,561	700,654	743,193
Excise taxes:							
Federal funds:							
Alcohol taxes	8,105	7,909	8,056	8,190	8,330	8,579	8,716
Proposed Legislation	....	....	–56	–19	....	....	....
Tobacco taxes	7,926	7,899	7,732	7,590	7,459	7,325	7,202
Transportation fuels tax	1,381	–526	–1,325	–1,417	–1,460	–1,481	–1,500
Proposed Legislation	....	....	12	13	13	13	14
Telephone and teletype services	5,997	6,485	6,881	7,292	7,717	8,158	8,619
Other Federal fund excise taxes	1,157	1,373	1,329	1,370	1,423	1,478	1,533
Proposed Legislation	....	–1,089	–1,206	–1,214	–1,268	–1,301	–1,333
Total Federal fund excise taxes	24,566	22,051	21,423	21,805	22,214	22,771	23,251
Trust funds:							
Highway	34,711	37,792	39,119	39,908	40,630	41,315	41,989
Proposed Legislation	....	1,089	1,107	1,119	1,137	1,151	1,160

Table 17–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2004 Actual	Estimate 2005	2006	2007	2008	2009	2010
Airport and airway	9,174	10,517	11,319	11,996	12,651	13,346	14,077
Aquatic resources	416	424	426	439	451	466	479
Tobacco	....	1,098	1,089	964	964	964	964
Black lung disability insurance	566	584	601	618	636	650	660
Inland waterway	91	91	92	93	93	94	95
Vaccine injury compensation	142	170	188	192	194	196	199
Leaking underground storage tank	189	97	....	....	....	....	....
Proposed Legislation	....	100	202	103	....	....	....
Total trust funds excise taxes	45,289	51,962	54,143	55,432	56,756	58,182	59,623
Total excise taxes	**69,855**	**74,013**	**75,566**	**77,237**	**78,970**	**80,953**	**82,874**
Estate and gift taxes:							
Federal funds	24,831	23,754	26,810	24,628	25,973	27,625	21,509
Proposed Legislation	....	....	–689	–1,162	–1,649	–1,612	–1,371
Total estate and gift taxes	**24,831**	**23,754**	**26,121**	**23,466**	**24,324**	**26,013**	**20,138**
Customs duties:							
Federal funds	20,143	22,100	25,643	27,954	29,918	31,861	33,195
Proposed Legislation	....	1,608	1,540	1,512	734	736	739
Trust funds	940	966	1,073	1,170	1,246	1,295	1,345
Total customs duties	**21,083**	**24,674**	**28,256**	**30,636**	**31,898**	**33,892**	**35,279**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	96	100	110	106	106	106	106
Proposed Legislation	....	....	....	4	4	5	5
United Mine Workers of America combined benefit fund	127	96	119	128	125	122	119
Deposit of earnings, Federal Reserve System	19,652	24,102	28,528	32,197	36,076	39,441	42,239
Defense cooperation	13	7	7	8	8	8	8
Confiscated Assets	18	....	....	....	....	....	....
Fees for permits and regulatory and judicial services	8,675	9,625	10,049	10,360	10,316	10,004	10,058
Proposed Legislation	....	....	304	312	318	322	323
Fines, penalties, and forfeitures	3,902	4,252	4,276	4,265	3,551	3,592	3,633
Proposed Legislation	....	–1,608	–1,615	–1,624	–855	–865	–874
Gifts and contributions	153	195	188	187	188	190	192
Refunds and recoveries	–71	–326	–328	–336	–344	–352	–359
Total miscellaneous receipts	**32,565**	**36,443**	**41,638**	**45,607**	**49,493**	**52,573**	**55,450**
Total budget receipts	**1,880,071**	**2,052,845**	**2,177,550**	**2,344,154**	**2,507,011**	**2,650,003**	**2,820,878**
On-budget	1,345,326	1,491,482	1,584,359	1,714,972	1,842,450	1,949,349	2,077,685
Off-budget	534,745	561,363	593,191	629,182	664,561	700,654	743,193
MEMORANDUM							
Federal funds	1,100,875	1,228,758	1,307,760	1,423,134	1,539,578	1,633,820	1,746,109
Trust funds	495,410	545,688	637,748	665,392	694,810	727,810	765,078
Interfund transactions	–250,959	–282,964	–361,149	–373,554	–391,938	–412,281	–433,502
Total on-budget	**1,345,326**	**1,491,482**	**1,584,359**	**1,714,972**	**1,842,450**	**1,949,349**	**2,077,685**
Off-budget (trust funds)	**534,745**	**561,363**	**593,191**	**629,182**	**664,561**	**700,654**	**743,193**
Total	**1,880,071**	**2,052,845**	**2,177,550**	**2,344,154**	**2,507,011**	**2,650,003**	**2,820,878**

[1] Deposits by States cover the benefit part of the program. Federal unemployment receipts cover administrative costs at both the Federal and State levels. Railroad unemployment receipts cover both the benefits and adminstrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds.